

2009

Tax - U.S. GAAP - IFRS

Lauren Matta
University of Redlands

Follow this and additional works at: https://inspire.redlands.edu/cas_honors

 Part of the [Accounting Commons](#), [Corporate Finance Commons](#), and the [Taxation Commons](#)

Recommended Citation

Matta, L. (2009). *Tax - U.S. GAAP - IFRS* (Undergraduate honors thesis, University of Redlands). Retrieved from https://inspire.redlands.edu/cas_honors/73



This work is licensed under a [Creative Commons Attribution-NonCommercial 4.0 License](#)

This material may be protected by copyright law (Title 17 U.S. Code).

This Open Access is brought to you for free and open access by the Theses, Dissertations, and Honors Projects at InSPIRe @ Redlands. It has been accepted for inclusion in Undergraduate Honors Theses by an authorized administrator of InSPIRe @ Redlands. For more information, please contact inspire@redlands.edu.

Tax – U.S. GAAP – IFRS

Understanding the Book-Tax Gap with a Convergence among U.S. GAAP and IFRS

Lauren Matta
Spring 2009

Tax – U.S. GAAP – IFRS

Understanding the Book-Tax Gap with a Convergence among U.S. GAAP and IFRS

Lauren Matta
Spring 2009

Executive Summary

The involvement in international trade is an increasingly popular characteristic of all business operations. Companies today are crossing national borders and engaging in foreign business operations in order to gain a competitive advantage. The use of global accounting standards within the United States is anticipated to facilitate the free flow of capital and increase investor confidence.

Through factual research and company analysis, this paper will be examining the effects that a convergence among United States Generally Accepted Accounting Principles and International Financial Reporting Standards will have on income taxes through not only the assessment of the differences between the two income tax accounting standards, but also various significant differences among the two GAAPs that will affect the bottom line of a company. This goal of this paper is to add to the understanding of how a convergence among U.S. GAAP and IFRS will affect the gap between what a company reports as income to investors through financial statements, and what companies report as income for tax purposes.

The first chapter will provide a fundamental overview of the history and background of International Financial Reporting Standards and the organization that supports the development of such. The second chapter focuses on various significant differences in the accounting of specific income statement and balance sheet accounts between U.S. GAAP and IFRS. The third chapter discusses the differences between SFAS 109 and IAS 12, the standards for income tax accounting under U.S. GAAP and IFRS respectively. These two chapters compare a theoretical approach that the effect of the differences will have in regards to the book-tax gap. In the fourth chapter, a numerical analysis of the impact on individual companies will be discussed and examined. Lastly, the fifth chapter acts to tie together the entire paper and provide concluding results.

Chapter #1
History and Background of International Financial Reporting Standards

The Road to International Financial Reporting Standards

As a result of today's high-speed communications and increasingly linked markets, investors, issuers, and other capital market participants are crossing national borders to make investment, capital allocation, and financing decisions. In order to enhance the ability to compare financial information of U.S. and non-U.S. companies, the Securities and Exchange Commission (SEC) has proposed the required use of International Financial Reporting Standards. The conversion will not only impact various reporting standards currently used under U.S. Generally Accepted Accounting Principles (GAAP), but more specifically, will affect the gap between reported financial income and reported income for tax purposes. Through a theoretical and analytical approach, the implications regarding book-tax differences of a U.S. convergence with IFRS will be discussed. Since the conversion appears inevitable, companies and businesses across the nation are already beginning to prepare for the upcoming transition to international standards.

Internationalization of business activities has become the norm, and the advantages of a single set of financial reporting standards are obvious. The goal of having uniform, high-quality standards is the facilitation of cross-border capital flows, reducing barriers to both trade and the flow of capital. It will become easier for non-U.S. companies to access capital markets in the U.S. A convergence to international standards will have a notable effect on all aspects and personnel of business. Investors will have access to more reliable and consistent financial data used to compare and analyze performance in multiple jurisdictions. Preparers and listed entities will have easier access to global investors, potentially reducing their cost of capital and

eliminating the costs of conforming to difference requirements in different jurisdictions. Regulators will also benefit from greater consistency and supposed quality of information.¹

The International Accounting Standards Board (IASB), the issuer of International Financial Reporting Standards, more commonly referred to as IFRS, has a mission to develop, in the interest of the public, a single set of high quality and understandable financial reporting standards.² As of the middle of 2008, over 100 countries worldwide currently require or permit IFRS reporting. Of these aforementioned, jurisdictions such as Barbados, South Africa, and Lebanon, among others, require the use of IFRS for all domestically listed companies. In 2002, the European Parliament passed a resolution, which required companies listed on European stock exchanges to begin applying IFRS for the preparation of financial statements with a fiscal year ending on or after January 1, 2005. Unlike other jurisdictions however, a private-sector standards setter, the European Commission (EC), must endorse the standards before they are required in the EU. Thus, the EC retains the power to reject any standard in full or part, however, to date no standards have been rejected.³ Seeing as the EU does not endorse the full set of IFRS, when describing the compliance of financial statements with international standards, companies instead state “IFRS as adopted by the EU.” This notion of adopting IFRS in part rather than an absolute conversion is widely becoming accepted, despite the notion that it does not seem to put the IASB closer to the goal of one absolutely dominant set of accounting standards.

At roughly the same time as the EU’s adoption of IFRS, the Australian Accounting Standards Board (AASB) issued upwards of forty accounting standards that are referred to as

¹ Epstein, Barry Jay, “The Economic Effects of IFRS Adoption: Investigating the Expected Benefits,” *The CPA Journal*, March 2009, pgs. 26-31.

² International Accounting Standards Board, “IASB Homepage,” <http://www.iasb.org/Home.htm> (Accessed January 15, 2009).

³ C. Armstrong and others, “Market Reaction to the Adoption of IFRS in Europe,” <http://ssrn.com/abstract=903429> (Accessed January 15, 2009), 4.

Australian equivalents to IFRS. These standards, abbreviated as A-IFRS, are not however, consistent with IFRS due in part to various additional disclosures, wording amendments in order to accommodate the Australian legislative environment, and additional/amended requirements for non-profit organizations.⁴ Due to the increasing number of countries adopting IFRS to some extent, as well as the recent acceptance of IFRS by the EU and the proposed future acceptance of IFRS in full by countries such as Canada and Japan, regulatory agencies, issuers, and other users of financial statements in the United States are preparing in advance of the proposed convergence date.

In late 2002, The Financial Accounting Standards Board (FASB), the private sector organization in the U.S. designated by the Securities and Exchange Commission to establish financial accounting and reporting standards, met with the IASB and pledged to “use their best efforts to (a) make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate their future work programs to ensure that once achieved, compatibility is maintained.”⁵ This meeting and resulting memorandum, having had taken place in Norwalk, Connecticut, became titled “The Norwalk Agreement.” Subsequent to this meeting, the Securities and Exchange Commission issued proposed milestones regarding the mandatory use of IFRS by U.S. issuers. If achieved, in 2011 the Commission will determine whether to proceed with rulemaking to require that U.S. issuers use IFRS beginning in 2014. These milestones deal with the improvements in accounting standards, the accountability and funding of the IASC Foundation, the improvement in the ability to use interactive data for IFRS reporting, education and training, limited early use of IFRS where this would enhance comparability for

⁴ Deloitte, “A-IFRS vs IFRS: Differences between Australian equivalents to International Financial Reporting Standards (A-IFRS) and International Financial Reporting Standards (IFRS),” September 2005, <http://www.iasplus.com/au/0509differences.pdf>.

⁵ Financial Accounting Standards Board, “Memorandum of Understanding - ‘The Norwalk Agreement,’” www.fasb.org/news/memorandum.pdf (Accessed January 15, 2009).

U.S. investors, the anticipated timing of future rulemaking by the Commission, and the implementation of the mandatory use of IFRS by U.S. users.⁶

In recent months however, the SEC has become preoccupied with emerging issues such as responding to the financial crisis, the effect on its own reputation from the Bernard Madoff alleged Ponzi scheme, and a change in leadership. In response to the issues that arose, the SEC has extended the public comment period regarding its proposed milestone for moving all U.S. public companies to IFRS by two months. Newly appointed chairperson of the SEC, Mary Shapiro, has already raised concerns about the current roadmap such as the pace, and the adoption of IFRS as a whole, such as the independence of the IFRS and the overall quality of the rules.

Shapiro, having assumed office on January 22, 2009, is the 29th chairperson of the U.S. Securities and Exchange Commission, and takes office at a very crucial time. It is expected that comments received from companies, auditors, and investors will be focused on providing more guidance and direction than is disclosed in the current roadmap. Also expected as a result of the comments is the delay of the roughly 110 companies that qualify as early adopters. These companies, chosen based on size and industry, are proposed to use IFRS for their SEC filings for fiscal years beginning on or after December 15, 2009. Nonetheless, as it stands, the SEC still holds that a definitive decision will be made regarding the use of IFRS by the year 2011.⁷

Historically, the United States has been opposed to the required or permitted use of IFRS-based financial reporting due to the concern that international standards were not of the same quality as U.S. GAAP. Over time however, such concerns have been raised and have begun to

⁶ Securities and Exchange Commission, "Roadmap for the Potential Use of Financial Statements prepared in Accordance with International Financial Reporting Standards by U.S. Issuers," <http://sec.gov> (Accessed January 15, 2009).

⁷ Johnson, Sarah, "SEC Pushed Back IFRS Roadmap: by extending the comment period, the SEC could impede large U.S. companies from getting a head start on adopting the global rules," (February 4, 2009), <http://cfo.com>.

be addressed. For example, in 2001 the IASB adopted a due process essentially identical to that of the FASB. With the IASB and FASB working closely together the quality of standards has improved, and will continue to improve as new standards are being set in the future.⁸

Organization of the International Accounting Standards Committee Foundation

The International Accounting Standards Committee Foundation (IASC Foundation) is the independent not-for-profit private sector organization whose standard setting body is the IASB. The IASC Foundation promotes the use and rigorous application of IFRS while also taking into account the needs of small and medium sized entities and emerging economies. The governance, oversight, and funding of the IASC Foundation is the responsibility of 22 appointed Trustees. Each Trustee is appointed for a three-year renewable term and is proportionately selected from three regions, which include Asia/Oceania, Europe, and North America.⁹ The current U.S. equivalent to the IASC Foundation is the Financial Accounting Foundation (FAF), which is the independent, private-sector organization with responsibility for establishing, educating other on, and improving accounting and reporting standards, as well as protecting the independence and integrity of the standard setting process.¹⁰

The IASB develops international financial reporting standards following an international consultation process, involving interested individuals and organizations from around the world with the support of an external advisory council, the Standards Advisory Committee (SAC). The SAC is set-up as a forum so the IASB can consult a diverse range of representatives from preparers, financial analysts, auditors, academics, and regulators, among others. Meeting three

⁸ Epstein, Barry Jay, "The Economic Effects of IFRS Adoption: Investigating the Expected Benefits," *The CPA Journal*, March 2009, pgs. 26-31.

⁹ International Accounting Standards Board, "IASB Homepage," <http://www.iasb.org/Home.htm> (Accessed January 15, 2009).

¹⁰ Financial Accounting Foundation, "FAF Homepage," <http://fasb.org/faf/index2.shtml> (Accessed April 10, 2009).

times a year, this committee advises the IASB on particular issues, including the implementation and application of existing standards. Like the IASB, the Financial Accounting Standards Board (FASB) in the U.S. has been delegated the authority to establish financial accounting standards, and the Financial Accounting Standards Advisory Council (FASAC) is the group of FASB constituents which consults the Board on technical issues, project priorities, and other key matters.¹¹

Another key committee is the International Financial Reporting Interpretations Committee (IFRIC). The aforementioned is the interpretive body of the IASC Foundation and reviews widespread accounting issues that have arisen within the context of current international standards and provides authoritative guidance on those issues. The 14 voting members of the IFRIC are appointed by the Trustees and come from a variety of regions and professional backgrounds.¹²

International Financial Reporting Standards in and of themselves, are a set of established accounting standards adopted by the London based IASB. Many of the standards forming part of IFRS are known as International Accounting Standards (IAS). These standards were issued from 1973 up until April of 2001 when the IASB adopted all International Accounting Standards, continued their development, and renamed them IFRS. These standards are developed through an international consultation process and consist of six stages.

Process for the Development of International Financial Reporting Standards

The first stage in developing standards is setting the agenda, where the IASB considers the relevance and reliability to users of the information, any existing guidelines, the possibility of

¹¹ IBID.

¹² International Accounting Standards Board, "IASB Homepage," <http://www.iasb.org/Home.htm> (Accessed January 15, 2009).

increasing convergence, the quality of the standard being developed, and any resource constraints. During the project planning stage the IASB decides whether to conduct the project alone or jointly with another standard-setter and establishes a working group, or team. Although not mandatory, the IASB typically publishes a discussion paper, which includes an overview of the issue being addressed, possible approaches to take, preliminary views, and an invitation to comment. Unlike the discussion paper, the development and publication of an exposure draft is mandatory, which sets out a specific proposal in the form of a proposed standard. After feedback is received, and the IASB has carried out meetings regarding a specific issue, the development and publication of an IFRS takes place. At this point, the IASB can either publish its revised proposals for another round of comments, or draft the IFRS. Finally, after the due process is completed, all outstanding issues are resolved, and the IASB members have balloted in favor of publication, the IFRS is issued. Even after the issuance however, the IASB holds regular meetings to anticipate future issues that may arise and the impact that potential proposals may have.¹³

The Standing Interpretations Committee developed interpretations prior to the year 2001. The International Financial Reporting Interpretations Committee has been developing interpretations since that time, due to the renaming that the IASB undertook in early 2001. Developing interpretations, like standards, is in accordance with a due process of consultation and debate.

There are seven clearly identified steps regarding the development of interpretations, the first of which being the identification of issues to be considered by the IFRIC, which is the primary responsibility of its members and appointed observers. The committee then sets the

¹³ International Accounting Standards Board, "IASB Homepage," <http://www.iasb.org/Home.htm> (Accessed January 18, 2009).

agenda by either adding a proposed issue or setting a consultative period for those issues not added. The IFRIC then discusses proposed items to be added to the agenda. The interpretation is subsequently drafted and voted on, with consensus being achieved when no more than four members have voted against the proposal. The draft of the interpretation is then released and is made available for public comment for not less than 60 days. All comments received during the comment period are considered by the IFRIC before an interpretation is finalized. Lastly, after the IFRIC has reached a consensus regarding the interpretation, it is sent to the IASB for ratification before being issued.¹⁴

Although the mission of the IASB is to provide a single set of high quality, understandable international financial reporting standards, this is not to say that implementation and convergence will occur without costs, whether they are measured nominally as dollar figures or economically as time and resources. In order to smooth the convergence in the United States, the SEC has proposed a timeline regarding several major milestones leading to the required use of IFRS by U.S. issuers for the year 2014.¹⁵ The achievement of these milestones may result in the required use of IFRS for issuers in the coming future.

A convergence with IFRS will have a significant impact on businesses, regulators, investors, and other such financial instrument users and organizers. The implications on a company's bottom line and taxable income will be different than under U.S. GAAP. Tax professionals will now not only need to understand the differences between IAS 12 and FAS 109, the standards regarding income tax accounting, but also the pretax differences between IFRS and U.S. GAAP, and the relationship between IFRS and the statutory tax laws of each jurisdiction in

¹⁴ IBID.

¹⁵ Securities and Exchange Commission, "Roadmap for the Potential Use of Financial Statements prepared in Accordance with International Financial Reporting Standards by U.S. Issuers," <http://sec.gov> (Accessed January 15, 2009), 1.

which their company operates. Through both theoretical and numerical analysis, it will be shown how a convergence among U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards will affect the gap between what a company reports as income through required financial statements, and what companies report as income for tax purposes.

Objectives of Financial Reporting by Business Enterprises

As stated in the FASB's Statement of Financial Accounting Concepts No. 1 *Objectives of Financial Reporting by Business Enterprises*, "financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence."¹⁶ Although financial accounting is not designed to directly measure the value of a business enterprise, the information provided should be helpful to those who wish to estimate its value. The decision usefulness of financial statements is an important concept to those who depend on such information to reliably and accurately make assessments about a company's financial position. It is important to understand that specific concepts and changes in financial reporting can impact the decision usefulness of financial statements.

Within the scope of this paper, the concepts of deferred tax and a convergence to IFRS have the potential to either convolute, increase, or keep the decision usefulness of reported financial information the same. Deferred tax has not been highly debated for some time now, despite the fact that the complexity of the issue remains high. The debate historically centered

¹⁶ Financial Accounting Standards Board, "Statement of Financial Accounting Concepts No. 1: Objectives of Financial Reporting by Business Enterprises," http://www.fasb.org/pdf/aop_CON1.pdf, CON1-1.

on the different methods used to account for deferred tax and the effects that each may have on profitability. Deferred tax, being an area in financial reporting that is not easily understood, will continue to remain highly complex even with a move to international standards. This high level of complexity however, can impede the understandability of financial statements. For example, deferred tax assets are shown on the face of financial statements as an asset, but they may in fact never be recovered. Additionally, the timing of the ultimate payment of deferred tax liabilities may vary significantly.

International financial reporting standards may represent a significant cost savings opportunity for global companies with several advantages. These said advantages as identified by financial executives include improved accounting and financial reporting policies through standardization, increased availability and improved efficient use of resources, improved control over statutory reporting, and better cash management.¹⁷ The key distinction is the standardization and comparability of financial statements across borders. Despite some jurisdictions not adopting IFRS in full, like the U.S., the IASB works closely with the local standard setting body to bring the two sets of standards so closely into alignment that users would find the differences essentially irrelevant to investing and other decisions. Through a convergence to IFRS, there is likely to be reduced complexities, greater transparency, increased comparability, and improved efficiency. It is anticipated that IFRS financial statements will benefit investors and companies, as well as capital markets as a whole. Acceptance of IFRS however, does not come without its challenges, which is why some companies are beginning to prepare well in advance of the possible convergence date.

¹⁷ Deloitte, "International Financial Reporting Standards for U.S. Companies: Implications of an accelerating global trend," 2007, [http://www.deloitte.com/dtt/cda/doc/content/us_assurance_international_financial_reporting_std%20030108\(1\).pdf](http://www.deloitte.com/dtt/cda/doc/content/us_assurance_international_financial_reporting_std%20030108(1).pdf).

Chapter #2
Significant Disparities between U.S. GAAP and IFRS

Understanding the Book-Tax Gap

In the United States, public corporations use two different sets of accounting rules when preparing their financial statements for the Securities and Exchange Commission and their tax returns for the Internal Revenue Service (IRS). Due to the fact that there are differences between the rules to report earnings to investors and the IRS, a gap results.¹⁸ Over the years, this gap has been termed the book-tax accounting gap, and has been a controversial topic as the differences between reported earnings and taxable income continues to fluctuate over the years. On the other hand however, there are numerous places where the two rules are linked, and the tax code is dependent on U.S. GAAP, which could make a convergence to IFRS more challenging. If and when the United States adopts international standards, due to the already various disparities between U.S. GAAP and IFRS, the effect on the book-tax accounting gap may be significant.

Historically, accounting for income taxes became a significant issue in the 1940s when the Internal Revenue Code permitted companies to depreciate the cost of emergency facilities considered essential to the war effort over a period of 5 years, which reduced taxable income. The concept of interperiod tax allocation is that income tax expense should be allocated to periods so that items reported on the income statement are matched with their respective tax consequences. Also, because revenues are taxable when taxpayers receive cash and expenses are deductible when cash is paid, which is more consistent with cash basis accounting, the IRC's reporting requirements differ from the reporting requirements for financial accounting as defined by GAAP. Because of this, the taxes paid in a given year may not reflect the tax consequences of events and transactions that are reported in the income statement for that same year. When

¹⁸ Celia Whitaker, "Bridging the Book-Tax Accounting Gap," *The Yale Law Journal* (2005), 682.

revenues and expenses are required to be recognized in different accounting periods from GAAP, taxable income is temporarily different from pretax financial accounting income.

The gap between a company's reported income and taxable income is generated through various temporary and permanent differences. Temporary differences are differences between pretax financial accounting income and taxable income that affects two or more accounting periods resulting in the allocation of income between periods. These arise due to the timing of revenues, gains, expenses, or losses in financial accounting income occurring in a different period from taxable income. These timing differences however, will reverse in later periods, ultimately becoming the same amount. Permanent differences on the other hand, represent fundamental changes in how an amount of income or expense is treated. A permanent difference arises when either specific provisions of the IRC exempt certain types of revenues from taxation or prohibit the deduction of certain types of expenses or the IRC allows tax deductions that are not expenses under GAAP. These permanent differences affect either pretax financial accounting income or taxable income, but never both.

The toleration of the book-tax gap comes from the basic understanding that financial accounting and tax accounting have two very different goals, which require separate approaches. The goal of financial accounting is to provide current and potential investors with an accurate picture of a corporation's economic position. Federal income taxation however, is intended primarily to raise money for the government.¹⁹ Supporters of the gap argue that a unified system may not be able to accommodate the differing objectives, thus beginning in 1964; the IRS has required that corporations reconcile their book and taxable income through Schedule M-1 of Form 1120. Although this reconciliation was helpful in providing information regarding the gap created, the information was minimal and incomplete. This form made no mention to whether

¹⁹ IBID, 683.

the differences were temporary or permanent, and the book-tax income reconciliation schedule did not start from the same consolidated group for tax purposes.²⁰ In January of 2004 however, the IRS proposed a new reconciliation form, Schedule M-3, which for the first time allows the tax authorities to identify the causes of the book-tax income gap. This schedule applies to corporations with at least \$10 million in assets, and has the potential to increase the compliance burden for both taxpayers and practitioners.

It has become common knowledge, that due to the different goals of financial accounting and tax accounting, management has an incentive to report higher earnings on financial statements and lower earnings for tax purposes. Since 1991, it has been highly controversial when a company's reported income book income, generated using U.S. GAAP, was significantly greater than income reported for tax purposes.²¹ It can easily be misunderstood however, that this gap only results due to tax sheltering behavior. The current tax-gap results from current book reporting requirements, or U.S. GAAP, and book reporting behavior, such as earnings management and fraud. Both of the previously mentioned items shape the book income.

Selected Significant Differences between U.S. GAAP and IFRS

A conversion to IFRS will have a significant impact on what tax professionals need to know and how they gather the information necessary to satisfy financial reporting and tax compliance requirements. In order to get ready for transition and implementation issues, further training will be necessary along with a revision to companies' accounting processes. Tax professionals will now not only need to understand the differences between IAS 12 and FAS 109,

²⁰ Weiner, Joann Martens, Closing the Other Tax Gap: The Book-Tax Income Gap. Tax Notes, Vol. 115, No. 9, May 28, 2007. Available at SSRN: <http://ssrn.com/abstract=988999>.

²¹ Seidman, Jeri, "Interpreting Fluctuations in the Book-Tax Income Gap as Tax Sheltering: Alternative Explanations," (2008).

the standards regarding income tax accounting, but also the pretax differences between IFRS and U.S. GAAP and the relationship between IFRS and the statutory laws of each jurisdiction in which their company operates. Some of the largest anticipated areas of concern regarding a convergence include fields such as inventories, financial instruments, provisions and contingencies, property, plant, and equipment, revenue recognition, research and development, and income taxes, of which the latter will be subsequently described in detail. Furthermore, among each stated area affecting a company's bottom line, there are secondary matters that need to be examined as well, for example, the accounting differences between U.S. GAAP and IFRS for various costing methods, measurement, and reversal of inventory write-downs all fall under the broader category of inventory.

Continuing with the previous brief example, one very important figure in determining a company's profit margin and ultimate income generated from business is the cost of goods sold. Relating directly to inventory, the use of various costing methods can manipulate the amount of gross profit a company reports on their income statement. Under U.S. GAAP, LIFO is considered an acceptable method and a consistent cost formula for all inventories similar in nature is not explicitly required. Conversely, IFRS prohibits the use of LIFO and the same cost formula must be applied to all inventories similar in nature or use to the entity.²² In a time of rising prices, the cost of goods sold figure would be reported as higher, consequently making net income lower, and vice versa during a time of falling prices. Due to this requirement, it appears that under IFRS there is less room for manipulation of income regarding the costing of inventory.

²² Ernst & Young, "U.S. GAAP v. IFRS: The Basics," (2007).

http://www2.eycom.ch/publications/items/2007_ey_us_gaap_v_ifrs_basics/2007_ey_us_gaap_v_ifrs_basics.pdf. 10.

Revenue Recognition

The areas of revenue recognition, property, plant, and equipment, and research and development will be discussed in detail regarding the differences between U.S. GAAP and IFRS, and the ultimate theoretical effect on reported net income that a conversion will have in these areas. Despite having significant similarities, the accounting for the recognition of revenues under U.S. GAAP and IFRS also has differences, which could possibly have a large impact on reported earnings. Generally, the amount of guidance regarding revenue recognition under IFRS is limited in comparison to that of U.S. GAAP, particularly relating to industry specific rules such as recognition relating to software revenue. With respect to the sale of goods, both GAAPs require recognition when the risks and rewards of ownership have been transferred, however, under U.S. standards there also must be persuasive evidence of the sale, a fixed or determinable fee, and reasonably assured collectibility. The accounting treatments for construction contracts are also noteworthy, in that under both GAAPs, if certain criteria are not met, the percentage-of-completion method cannot be used. If the percentage-of-completion method cannot be used, under U.S. GAAP, the completed contract method is used. Under IFRS however, revenue recognition is limited to recoverable costs incurred, and consequently, the completed contract method is not permitted, which may accelerate the recognition of revenue, subject to specific facts and circumstances.²³

In addition to stated differences among revenue recognition, specific types of service revenue, such as those primarily relating to services sold with software, have been separately addressed in U.S. GAAP extensively. Moreover, if there are multiple elements to a transaction,

²³ Ernst & Young, "U.S. GAAP v. IFRS: The Basics," (2007).

http://www2.eycom.ch/publications/items/2007_ey_us_gaap_v_ifrs_basics/2007_ey_us_gaap_v_ifrs_basics.pdf.
29-30

U.S. GAAP requires that specific criteria be met for an element to be considered a separate unit of accounting. This includes the idea that the delivered elements have standalone value, and undelivered elements have reliable and objective evidence of fair value. Under IFRS however, the recognition of revenue on an element of a transaction is required when it has standalone value, but otherwise the elements must be linked and accounted for as a single transaction. The last large disparity among revenue recognition regards the deferred receipt of receivables. U.S. GAAP limits the situations in which discounting to the present value to be required, however, IFRS requires that the value of revenue to be recognized be determined by discounting all future receipts using an imputed rate of interest.²⁴ The previously mentioned differences between U.S. GAAP and IFRS, as well as additional noteworthy differences, can be seen in full as well as compared to the current U.S. tax methods in the Appendix under Figure 1.

Property, Plant, and Equipment

Property, plant, and equipment (PP&E), also commonly referred to as fixed assets, describe assets and property that cannot easily be converted into cash. Under both accounting standards being discussed, PP&E is initially recognized at cost which includes all expenditures directly attributable to bringing the asset to the location and working condition for its intended use, as well as the cost to dismantle and remove the asset and restore the site. Additionally, like IFRS, U.S. GAAP defines the gain or loss on disposal as the difference between the net proceeds received and the carrying amount of the asset. Although there are numerous similarities between the accounting for PP&E under U.S. GAAP and IFRS, there are also significant inconsistencies.

²⁴ IBID, 29-30.

Under IFRS, all items in the same class of PP&E may be revalued at the same time to fair value if it can be measured reliably.²⁵

An important accounting issue involved in accounting for PP&E is depreciation, or the reduction in value of an asset over its useful life due to usage, passage of time, wear and tear, technological outdating, etc. Under U.S. GAAP and IFRS, PP&E is depreciated over the useful life, even if the asset is idle, but not held for sale. On the other hand however, these two standards differ when reviewing estimates and with regard to component accounting. IFRS requires estimates of useful life and residual value, and the method of depreciation, to be reviewed at least at each annual reporting date. U.S. GAAP requires these estimates to be reviewed only when events or changes in circumstances indicate that the current estimate or depreciation method is no longer appropriate. Lastly, international standards require that when a fixed asset comprises individual components for which different depreciation methods or rates are appropriate, each component be depreciated separately. U.S. GAAP permits but does not require component accounting.²⁶ Due to the aforementioned differences, IFRS results in greater income statement volatility due to the possibility for periodic adjustments in estimate. A complete comparison, as well as the evaluation of tax implications, can be seen in the Appendix through Figure 2.

²⁵ KPMG, "IFRS Compared to U.S. GAAP: An Overview," (May 2008), [http://www.kpmgifrsinstitute.com/documents/IFRS/721200810043IFRS%20compared%20to%20U.S.%20GAAP%20An%20Overview%20\(2008\).pdf](http://www.kpmgifrsinstitute.com/documents/IFRS/721200810043IFRS%20compared%20to%20U.S.%20GAAP%20An%20Overview%20(2008).pdf), 52-55.

²⁶ KPMG, "IFRS Compared to U.S. GAAP: An Overview," (May 2008), [http://www.kpmgifrsinstitute.com/documents/IFRS/721200810043IFRS%20compared%20to%20U.S.%20GAAP%20An%20Overview%20\(2008\).pdf](http://www.kpmgifrsinstitute.com/documents/IFRS/721200810043IFRS%20compared%20to%20U.S.%20GAAP%20An%20Overview%20(2008).pdf), 52-55.

Research and Development

Research and development, a crucial factor in the survival of particular companies in fast changing industries, refers to the “creative work undertaken on a systematic basis in order to increase the stock of knowledge, including knowledge of man, culture and society, and the use of this stock of knowledge to devise new applications.”²⁷ Falling under the category of intangible assets, there is a major difference in the way the United States currently accounts for research and development (R&D) costs, and the way they are accounted for under international standards. Under U.S. GAAP, both internal research and development expenditures are expensed as incurred unless addressed by a separate standard. For example, these separate standards specifically apply to the treatment of costs associated with the development of software for sale to third parties. Under IFRS however, internal research expenditure is expensed as incurred, but internal development expenditure is capitalized if specific criteria is met.²⁸ Costs in the development phase are capitalized if the technical feasibility of the completed intangible asset is demonstrated, there is intent to complete the intangible asset, the ability to use or sell the intangible asset is demonstrated, how the intangible asset will generate future economic benefits is identified, there are adequate resources available to complete the development, and the ability to measure reliably the expenditure attributable to the intangible asset during its development is demonstrated.²⁹ Despite the fact that under both standards research costs are expensed as incurred, under IFRS, some development costs may be capitalized, reducing expenses in research

²⁷ Organization for Economic Co-operation and Development, “OECD Factbook 2008: Economic, Environmental and Social Statistics,” <http://puck.sourceoecd.org/vl=3379343/cl=12/nw=1/rpsv/factbook/070101.htm>.

²⁸ KPMG, “IFRS Compared to U.S. GAAP: An Overview,” (May 2008), [http://www.kpmgifrsinstitute.com/documents/IFRS/721200810043IFRS%20compared%20to%20U.S.%20GAAP%20An%20Overview%20\(2008\).pdf](http://www.kpmgifrsinstitute.com/documents/IFRS/721200810043IFRS%20compared%20to%20U.S.%20GAAP%20An%20Overview%20(2008).pdf), 56-59.

²⁹ PriceWaterhouseCoopers, “IFRS and U.S. GAAP: Similarities and Differences,” *IFRS Readiness Series*, (September 2008), <http://www.pwc.com/extweb/pwcpublishations.nsf/docid/598E9D7EDF5239A0852574AB00659431>, 67.

and development on a company's income statement, which essentially increases reported earnings. A summary of these findings as well as a comparison to U.S. tax methods can be seen in the Appendix as Figure 3.

Theoretical Concluding Statements

The previously highlighted differences between U.S. GAAP and IFRS represent the theoretical examination of how a conversion to IFRS may impact the income a company reports for financial purposes. It can be seen that reporting under IFRS requires more judgment as there is less guidance regarding certain standards. Despite this, several conclusions can be drawn. Regarding revenue recognition, under IFRS, recognition of income is perceived to be accelerated in comparison to current U.S. standards. In context with tax principles, larger deferred tax liability amounts may be seen since there may be earlier recognition of income for financial purposes than for tax purposes. However, there is a potential to decrease the book-tax gap due to specific similarities between IFRS and tax principles regarding revenue recognition.

Considering property, plant, and equipment, despite there being the possibility to both reduce and create book-tax differences, there are other important implications that should be noted. It is anticipated that very few taxpayers will choose to use the fair value model for book purposes under IFRS, and even if the fair value model is chosen, it will be used only for certain asset classes that will not be too difficult to track for tax purposes. Despite this, those who choose to use the fair value model should maintain records that show the cost of the property acquired and disposed of for tax purposes. This along with the fact that regarding the aggregation and separation of components of assets, it will be necessary to track different assets, different placed in service dates, and different disposal dates, describes the situation where

companies will begin to incur greater administrative burdens, especially in the early years of IFRS implementation.

Lastly, regarding research and development, there is a potential to reduce the book-tax gap since IFRS will eliminate the book-tax basis differences in connection with acquired-in-process research and development that is written-off under U.S. GAAP. However, there likely will continue to be book-tax differences under IFRS for the difference in recovery lives. All of the previously mentioned conclusions however, are simplified and are highly dependent on the nature of the company's operations, industry in which they operate, and strategic planning undertaken, among other things. It also should be noted that only three specific areas of the income statement and balance sheet have been discussed, only a fraction of what a company reports through their financial statements.

Chapter #3
SFAS 109 and IAS 12: Income Tax Accounting

Income Tax Accounting Overview

Through factual research, the examination of the effects that an IFRS conversion will have on income taxes through the assessment of the differences between income tax accounting standards under U.S. GAAP and IFRS will be highlighted. The income tax accounting standards under U.S. GAAP and IFRS are based on similar principles and fundamentally have the same objectives; however, there are still significant differences currently present. As a reaction to the various significant differences, stemming from the Norwalk Agreement in 2004 is the income tax convergence project, which is focused on reducing the difference between the two standards and will subsequently be discussed in detail.

One key concept when discussing income tax accounting is the notion of deferred taxes. Because there are differences between what a company can deduct for tax and accounting purposes, there will be a difference between a company's taxable income and income before tax. A deferred tax liability records the fact that the company will, in the future, pay more income tax because of a transaction that took place during the current period. Conversely, a deferred tax asset is an asset on a company's balance sheet that may be used to reduce any subsequent period's income tax expense. A valuation allowance is recognized if it is more likely than not that some portion or the entire deferred tax asset will not be realized.

The issues with deferred taxes that have arisen in the past seem to have centered on the valuation adjustments due to the write-down of deferred tax assets. Any write-down has the potential to cut into the income reported to shareholders, but many do not affect the income reported for tax purposes. Companies must generate enough taxable income in future years to take advantage of deferred tax assets otherwise a write-down is necessary. In the past few years, many companies have seen that this can pose a potentially large problem concerning covenants

that must be met as well as future difficulties in raising additional capital. In just the past few years General Motors Corp recorded a \$39 billion loss, which was largely driven by a deferred tax asset valuation adjustment. This valuation adjustment left General Motors with a negative net worth, thus the underlying question with deferred tax assets in general is whether the company will be highly profitable in the future, and if not, how will taxable income be generated to take advantage of the asset?³⁰

Notable Differences between SFAS 109 and IAS 12

SFAS 109 *Accounting for Income Taxes* and IAS 12 *Income Taxes* provide guidelines regarding income tax accounting under U.S. GAAP and IFRS, respectively. Despite various differences, which are intended to be reduced in the coming months, both standards necessitate the same fundamental requirements. One significant similarity is that both pronouncements require entities to account for both current and deferred taxes using the asset/liability method. This method, besides being balance sheet oriented, accrues and reports the total tax benefit or taxes payable that will actually be realized or assessed on temporary differences when their respective future taxable or deductible amounts are expected to occur. Under this method, income tax expense is the sum of, or difference between, the changes in deferred tax asset and liability balances and the current provision of income taxes. Additionally, the discounting of deferred taxes is not permitted under either accounting standard.

In the current literature, several significant differences in accounting for income taxes under U.S. GAAP and IFRS exist. The first noteworthy difference is the way in which the tax basis, or original cost of an asset, less accumulated depreciation, that goes into the calculation of

³⁰ Reuters, "Analysis: Ambac's deferred tax assets could punish the firm," <http://uk.reuters.com/article/bankingFinancial/idUKN2935551520080429?pageNumber=1> April 29, 2008.

a gain or loss for tax purposes, is determined. Under U.S. GAAP, the tax basis is strictly defined under the tax code, resulting in asset and liability amounts with little dispute. IFRS defines the tax basis however, as the amount that is deductible or taxable for tax purposes. Depending on management's intent to sell or recover the carrying amount, the determination of the tax basis will be affected.³¹

Additionally, under U.S. GAAP, if there is an uncertainty that exists, it is determined through FASB Interpretation No. 48, which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements. FIN No. 48, "*Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109*," became effective for fiscal years beginning after December 15, 2006, and clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109. This interpretation came about due to the tax issues causing many problems associated with compliance with Sarbanes-Oxley Section 404, resulting in numerous required financial statement restatements, the fact that the use of tax contingencies had become too flexible and were being used to manipulate income, and the reporting and disclosure of tax positions ultimately lacked transparency. Within the interpretation is a two-step process used to evaluate a tax position consisting of recognition and measurement. The process of recognition determines whether it is more likely than not that a tax position will be sustained upon examination. Additionally, the measurement process determines the amount of benefit to recognize in the financial statements and measures at the largest cumulative amount of benefit that is greater than 50 percent likely of being realized upon ultimate selection.

³¹Ernst & Young, "U.S. GAAP v. IFRS: The Basics," (2007).
http://www2.eycom.ch/publications/items/2007_ey_us_gaap_v_ifrs_basics/2007_ey_us_gaap_v_ifrs_basics.pdf, 25.

FIN No. 48 indicates that tax positions that previously did not meet the more likely than not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met, and that previously recognized tax positions that no longer meet the more likely than not recognition threshold should be de-recognized in the first subsequent financial reporting period in which that threshold is no longer met. Due to the extensive guidelines regarding uncertain tax positions under U.S. GAAP, there is a great disparity between the position taken by international standards since IAS 12 does not define specific guidelines indicating that tax assets and liabilities should be measured at the amount that is expected to be paid.

Another issue stemming from the convergence of SFAS 109 and IAS 12 regards the fact that the carrying value of an asset on initial recognition sometimes differs from its tax base. Currently, under IFRS, the recognition of deferred tax effects arising from the initial recognition of an asset or liability that arises from a business combination conditional on the fact that the transaction affects either accounting or taxable profit is allowed. Under U.S. GAAP however, there is not an exemption for non-recognition of deferred tax effects for certain assets or liabilities. Consequently, and as mentioned earlier, deferred taxes are a key concept to understand when discussing the timing and measurement of reported income tax expense for a particular period. Recognized in full under U.S. GAAP, deferred tax assets are reduced by a valuation allowance, which essentially reduces the asset to the amount that is more likely than not to be realized. Although the fundamental accounting under both GAAPs regarding the recognition of deferred tax assets, the terminology deviates some. IFRS recognizes those amounts of deferred tax assets that are probable to be realized.³²

³² Ernst & Young, "U.S. GAAP v. IFRS: The Basics," (2007).

http://www2.eycom.ch/publications/items/2007_ey_us_gaap_v_ifrs_basics/2007_ey_us_gaap_v_ifrs_basics.pdf. 26.

Despite the fact that both U.S. GAAP and IFRS require companies to account for deferred taxes using the asset/liability approach, the calculation and classification differs slightly between the two standards. Both deferred tax assets and liabilities are to be measured at the tax rates that are expected to apply to the period in which the asset or liability is settled.³³ Under U.S. GAAP, it is required that enacted tax rates are used. The language under IFRS differs slightly however, in that enacted, or “substantively enacted” tax rates must be used that correspond with the balance sheet date. Additionally, IFRS requires that all deferred tax asset and liability amounts be classified as non-current in the balance sheet, while U.S. GAAP bases whether the deferred tax asset or liability is current or non-current based on the nature of the related asset or liability.³⁴

The last significant difference between SFAS 109 and IAS 12 that will be highlighted is the accounting for the recognition of deferred tax liabilities from investments in subsidiaries or joint ventures. U.S. GAAP does not require recognition for investments in foreign subsidiaries or corporate joint ventures unless it is evident that the difference will reverse in the foreseeable future. If the investment is deemed to be essentially permanent in its duration, then recognition is not required. Under IFRS however, the recognition of such investments is required unless the reporting entity has control over the timing of the reversal of the temporary difference and it is probable that the difference will not reverse in the foreseeable future.³⁵

Additional similarities and differences between the discussed accounting standards can be seen in the Appendix as Figure 4. One area that should be highlighted however, is the

³³ Deloitte, “IAS Plus Homepage,” Deloitte Touche Tohmatsu, <http://www.iasplus.com/index.htm> (accessed February 10, 2009).

³⁴ Ernst & Young, “U.S. GAAP v. IFRS: The Basics,” (2007).

http://www2.eycom.ch/publications/items/2007_ey_us_gaap_v_ifrs_basics/2007_ey_us_gaap_v_ifrs_basics.pdf. 26.

³⁵ Ernst & Young, “U.S. GAAP v. IFRS: The Basics,” (2007).

http://www2.eycom.ch/publications/items/2007_ey_us_gaap_v_ifrs_basics/2007_ey_us_gaap_v_ifrs_basics.pdf. 26.

classification of deferred taxes, which may have great unforeseen consequences. Under U.S. GAAP, there are two rules regarding the classification and balance sheet presentation of deferred taxes. To start, deferred tax assets and liabilities are classified as current or noncurrent based on classification of the related asset or liability for financial reporting. Consequently however, if deferred tax items are not related to an asset or liability, classification should be based on the expected reversal date of the temporary difference. An example of such an item includes deferred tax assets related to carry forwards.³⁶ Under IFRS however, deferred tax assets and liabilities are noncurrent. This could potentially impact the way in which investors and other users of the financial statements analyze companies, since deferred taxes will no longer be classified as current. The most basic consequence resulting from this is the impact on various balance sheet ratios and the overall analysis of a company's liquidity position.

Income Tax Convergence Project

In order to reduce the differences between SFAS 109 *Accounting for Income Taxes* and IAS 12 *Income Taxes*, the FASB and IASB have taken on a short-term convergence project. Despite the fact that the Board's approach to convergence is not to reconsider the underlying approach, exceptions to the basic principle are to be eliminated. In alignment with the IASB's due process for developing standards, the first three stages have already been completed, those being setting the agenda, project planning, and the development and publication of a discussion paper. As previously stated, the latter stage is not mandatory, therefore the IASB considered this not necessary for this project due to the fact that the objective is not to develop a new approach

³⁶ Becker CPA Review, "Financial Accounting & Reporting 6," DeVry/Becker Educational Development Corporation (2008).

to accounting for income taxes. The next step that the IASB will take is to issue an exposure draft of an IFRS to replace IAS 12, and a standard is planned to be finalized in the year 2010.³⁷

Within the joint exposure draft, there are current expectations as to how the various differences between accounting for income taxes under U.S. GAAP and IFRS will converge. For many of the previously stated tax accounting standards, IFRS is expected to simply converge with U.S. GAAP. More specifically, the areas of initial recognition exemption, recognition of deferred tax assets, the classification of deferred tax assets and liabilities within the balance sheet, and the recognition of deferred tax liabilities from investments in subsidiaries or joint ventures, are all expected to take on the standards that are currently used under U.S. GAAP. On the other hand however, there are a few stated areas where the two GAAPs currently differ. Through convergence, the IASB and FASB intend to define entirely new definitions for various areas of the accounting standard regarding income tax. Of the highlighted areas previously mentioned, the tax basis, accounting for uncertain tax positions, and the calculation of deferred tax assets and liabilities are proposed to be defined differently after the convergence of U.S. GAAP and IFRS.

Under the U.S. adopted International Financial Reporting Standards, it is expected that a proposal for a new definition for the tax basis will be implemented. This new definition will eliminate consideration of management's intent in the determination of the basis. Although this proposed definition takes on more characteristics of the U.S. GAAP definition of the tax basis, the amount of explanation will not be as extensive under the adopted IFRS. Regarding uncertain tax positions, the new adoption of IFRS is expected to take an approach, which does not include separate recognition criteria, as used in FIN 48. Instead, measurement of the benefit to be

³⁷ International Accounting Standards Board, "IASB Homepage," <http://www.iasb.org/Home.htm> (accessed January 30, 2009).

recognized is projected to be based on the probability weighted average of the possible outcomes. Lastly, the joint exposure draft identifies that IFRS is expected to clarify the definition of “substantively enacted” regarding the calculation of deferred tax assets and liabilities. For U.S. jurisdictions, this would simply mean when tax laws are enacted.³⁸

³⁸ Ernst & Young, “U.S. GAAP v. IFRS: The Basics,” (2007).
http://www2.eycom.ch/publications/items/2007_ey_us_gaap_v_ifrs_basics/2007_ey_us_gaap_v_ifrs_basics.pdf. 25.

Chapter #4
Analysis of Impact on Individual Companies

Background for Analysis

One of the largest global financial reporting changes within the past few years is the adoption of IFRS in Europe. Prior to 2005 most European firms applied domestic accounting standards. Not only were standards converged among European firms, but also modified international standards were implemented in order to converge with increasingly popular global standards. The adoption process began in early 2002 when the European Parliament passed a resolution requiring companies listed on European stock exchanges to prepare financial statements in accordance with IFRS for fiscal years beginning on or after January 1, 2005. In order to better understand the implications of a U.S. convergence to IFRS regarding specific areas of financial reporting, companies located in the United Kingdom, which were required to reconcile their IFRS financial statements back to U.S. GAAP, will be highlighted.

The ten selected companies used for analysis are defined as foreign private issuers which, as defined by the SEC, describes the fact that the company is a foreign issuer other than a foreign government, except when a firm meets the two following conditions: if more than fifty percent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States, and meets any of the three following criteria: the majority of the executive officers or directors are United States citizens or residents, more than 50 percent of the assets of the issuer are located in the United States, or the business of the issuer is administered principally in the United States. Companies falling under the stated criteria must file its annual report on Form 20-F within six months after the end of the fiscal year, which is being covered by the report. These companies were selected on the basis of location, being the United Kingdom, the requirement of reconciling back to U.S. GAAP, and having been registered with the U.S. Securities and Exchange Commission. Among the chosen, there are three major industries

represented which comprise of service companies, manufacturing companies, and financial services companies.

During late December 2007 however, the SEC issued final rules, which eliminated the requirement that foreign private issuers reconcile their financial statements to U.S. GAAP. This new rule applies to financial statements for fiscal years ending after November 15, 2007, however companies must satisfy three conditions. The first condition is that the financial statements are prepared in accordance with the English language version of IFRS as published by the IASB. Secondly, it must be stated within the notes to the financial statements that those financial statements are in compliance with IFRS as issued by the IASB. And lastly, an unqualified auditor's report stating that the financial statements are in compliance with IFRS as issued by the IASB.³⁹

The following analysis, which includes a basic analysis of IFRS on individual companies and an analysis of reconciling adjustments, provides an overall understanding of the impact of an IFRS adoption on individual companies. The purpose of the basic analysis is to show the impact of an IFRS adoption on a company's net income and the overall role that taxation plays. The analysis of reconciling adjustments provides a more complete examination of the role that taxation has on affecting a company's bottom line. The purpose of this analysis is to understand not only how companies are impacted by an IFRS adoption through the change in taxation methodology, but also how taxation is affected by all of the reconciling adjustments. Through trend analysis of companies and industries over time, the predictable effects of the reconciling adjustments companies report will be shown.

³⁹ Simpson Thacher & Bartlett LLP, "SEC Eliminates U.S. GAAP Reconciliation Requirement for IFRS Financial Statements of Foreign Private Issuers, *Simpson Thacher*."

Basic Analysis of Impact of IFRS on Individual Companies

It is first important to understand and grasp the overall effect that a convergence with IFRS will have on a company's reported net income, and how taxation under these new global standards is affected. The ten companies chosen for analysis purposes, as well as selected financial data is highlighted in the Appendix through Figure 5. As shown, for fiscal years 2005 and 2004, only two out of the ten selected companies reported a higher net income under U.S. GAAP than IFRS. For the fiscal year 2006 however, four companies reported a higher net income under U.S. GAAP. On average, the profit for the year attributable to equity holders of the parent under IFRS decreased by more than 44% in 2004, but only just over 6.5% in 2005, and 2.8% in 2006, when net income was reported under U.S. GAAP. This is consistent with the well-known and basic assumption that international accounting standards are intended to be broad, allowing many alternative accounting treatments to accommodate country differences. Over time however, the IASC has been able improve comparability among standards which can be seen though the average decrease in the three years shown.

In addition, it is important to note the basic tax consequences, which include the overall difference attributable to taxation and the absolute value of those taxation differences. For six out of the ten selected companies in 2004, and more noteworthy for nine of the ten companies in 2006, the difference attributable to taxation was a positive number, thus increasing reported net income under U.S. GAAP. It should be noted that there are two components to these taxation differences, the difference attributable to adjustments and the difference attributable to the change in methodology, both previously described theoretically.

Within the context of the various differences reported under IFRS and U.S. GAAP, it can be seen that taxation is a relatively significant portion. Due to the offsetting effects of increases

and decreases in reported amounts, the following calculations only take into account the absolute value of the changes from reported income under IFRS and U.S. GAAP. Although the difference attributable to taxation for some companies was very minimal, other companies reported significant differences due to this area. On average, the differences due to taxation were between 14% and 20% of the absolute value of all reported differences for the three years stated. When considering that numerous areas of the financial statements are affected due to an IFRS conversion, it is essential to understand that a material portion of those differences may be attributable to the two components of the differences in taxation.

Companies used for the Analysis of Reconciling Adjustments

Through a theoretical approach, the impact on the book-tax gap of a convergence between U.S. GAAP and IFRS on selected income statement and balance sheet accounts was examined. In order to understand the impact that the previously stated differences will have on individual companies, it is beneficial to recognize what comprises the adjustments that companies have reported when reconciling IFRS back to U.S. GAAP. The items that reduce reported income when reconciling back to U.S. GAAP and increase income are analyzed separately, and a complete set of charts can be seen in the Appendix as Figure 6.

Three of the chosen companies represent the service industry and include Vodafone Group, Reuters Group, and InterContinental Hotels Group. Vodafone Group is a public limited company, as all the selected companies are, is registered in England and operates as a mobile telecommunications company. The Group holds a significant global presence through the Company's subsidiaries and joint ventures. In the U.S., Vodafone Group's undertaking operates

as Verizon Wireless.⁴⁰ Reuters Group is a United Kingdom, Canadian controlled news service and former financial market data provider. In 2008 The Thomson Corporation purchased Reuters forming what is now an information company under operating under the name Thomson Reuters.⁴¹ InterContinental Hotels Group is an international hotel that franchises, manages, and owns hotels worldwide. InterContinental operates under seven hotel brands, which include the well known Holiday Inn and Crowne Plaza Hotels & Resorts.⁴²

Cadbury Schweppes, GlaxoSmithKline, and Diageo represent the selected manufacturing companies. Cadbury Schweppes was a confectionary and beverage company headquartered in London. After demerging in 2008, the global confectionary business and American beverage unit separated. Cadbury continues to be the world's largest confectionary manufacturer, while the beverage unit operates as Dr Pepper Snapple Group Inc.⁴³ GlaxoSmithKline is a research based pharmaceutical company headquartered in the United Kingdom with operations based in the United States. As the producer of medicines that treat six major disease areas, GlaxoSmithKline supplies one quarter of the world's vaccines.⁴⁴ Diageo is the world's leading premium drinks business and was formed after the merger of GrandMet and Guinness. With manufacturing facilities across the globe, Diageo claims to have an outstanding collection of beverage alcohol brands including Captain Morgan, José Cuervo, and Tangueray.⁴⁵

The last group of companies represents the Financial Services industry and includes Prudential, National Westminster Bank, Barclays, and The Royal Bank of Scotland. Prudential is an international retail financial services company structured around four main business units,

⁴⁰ Vodafone, "Vodafone Homepage," http://www.vodafone.com/hub_page.html (Accessed April 11, 2009).

⁴¹ Reuters, "Reuters Homepage," <http://thomsonreuters.com/about/> (Accessed April 12, 2009).

⁴² InterContinental Hotels Group, "IHG Homepage," <http://www.ihgplc.com/> (Accessed April 11, 2009).

⁴³ Cadbury, "Cadbury Homepage," <http://www.cadbury.com/Pages/Home.aspx> (Accessed April 11, 2009).

⁴⁴ GlaxoSmithKline, "GSK Homepage," <http://www.gsk.com/> (Accessed April 11, 2009).

⁴⁵ Diageo, "Diageo Homepage," <http://www.diageo.com/en-row/homepage.htm> (Accessed April 11, 2009).

which include Prudential Corporation Asia, Jackson National Life Insurance Company, Prudential U.K. & Europe, and M&G. Prudential provides a particular focus on saving for retirement and security in retirement.⁴⁶ Barclays is a major global financial services provider that is a holding company that operates through its subsidiary Barclays Bank. The bank's headquarters are located in London, however the company also operates Barclays Bank of Delaware, which issues Juniper credit cards.⁴⁷ The Royal Bank of Scotland Group has become one of the largest financial services groups in the world, and operates several businesses including personal banking, wealth management, business and commercial, and corporate and institutional. In the United Kingdom, The Royal Bank of Scotland Group includes The Royal Bank of Scotland, Ulster Bank in Ireland, and the last company used for analysis purposes, National Westminster Bank.⁴⁸ National Westminster Bank is a member of The Royal Bank of Scotland Group, operates as a commercial bank in the United Kingdom, and provides a full range of banking and insurance services to personal, business and commercial customers.⁴⁹

Analysis of Reconciling Adjustments

When reconciling back to U.S. GAAP, there are various adjustments that both increase and decrease net income across companies. In order to understand the overall significance of these items, a comparison among accounts is displayed over time by company, and segregated by accounts that increase and decrease net income. Additionally, a comparison is displayed regarding the reconciling adjustments that decrease net income across industry. It is important to

⁴⁶ Prudential, "Welcome to the World of Prudential Homepage," <http://www.prudential.co.uk/> (Accessed April 12, 2009).

⁴⁷ Barclays, "Barclays Homepage," <http://group.barclays.com/Home> (Accessed April 12, 2009).

⁴⁸ The Royal Bank of Scotland Group, "RBS Homepage," <http://www.rbs.com/> (Accessed April 12, 2009).

⁴⁹ National Westminster Bank, "NatWest Helpful Banking Homepage," <http://www.natwest.com/personal.ashx> (Accessed April 12, 2009).

note however, that these reconciling items affect companies reporting under IFRS and converting back to U.S. GAAP. When reporting under U.S. GAAP and converting to IFRS, there may be new reconciling items as well as reconciling items that no longer exist.

Through Figure 6 in the Appendix, graphical representations of reconciling adjustments can be seen segregated by company over time. Overall, it can be seen that reconciling adjustments that cause net income under U.S. GAAP to decrease or increase are volatile over time. From fiscal years 2004 to 2006, significant reconciling adjustments cannot be traced for many of the selected companies. For example, InterContinental Hotels Group has only one area, deferred revenue that is attributable to the decreasing effects of reconciling adjustments. For increasing effects on net income however, InterContinental Hotels Group has not one adjustment consistent over time. There are select companies that do however, report the same reconciling adjustments over time, such as Vodafone, GlaxoSmithKline, Prudential, and The Royal Bank of Scotland. Furthermore, some companies may report common reconciling adjustments in two of the three highlighted years, such as Reuters and Diageo.

Through Figure 7 of the Appendix, graphical representations of the decreasing effects of reconciling adjustments can be seen segregated by industry. It is evident that various reconciling adjustments affect individual companies differently, even across the same industry. One adjustment that is evident across all industries is pension and post retirement benefit costs, however despite being common, is not a significant effect in relation to other adjustments. A slight similarity among adjustments can be seen in the financial service industry between National Westminster Bank and The Royal Bank of Scotland. Several of the significant reconciling adjustments that decrease net income when reporting under U.S. GAAP are similar

between both companies. This can most likely be explained due to the fact that National Westminster Bank has been part of The Royal Bank of Scotland Group since the year 2000.

Analytical Application to Theoretical Conclusions

The four areas covered theoretically, deferred revenue, property, plant, and equipment, research and development, and income taxation, can also be applied to the analytical research in order to more wholly understand the impact that an IFRS convergence may have. Regarding deferred revenue, only one company reported a material decreasing effect of net income, which is consistent with the idea that revenue is recognized sooner under IFRS. If revenue is recognized sooner a larger deferred tax liability is shown, which could increase the book-tax gap.

Within the area of property, plant, and equipment, four companies reported material increasing or decreasing effects. These reconciling effects come from various aspects of property, plant, and equipment, including property revaluation, depreciation, impairment, and disposal. An absolute trend cannot be seen however, since some companies reported a material increasing effect, while some reported a material decreasing effect. This notion supports the conclusions found through a theoretical analysis, which is that there is both a potential to reduce and create book-tax differences.

The area of research and development, or the broader item of intangible assets, had a material decreasing effect of net income on several companies. These effects are mainly due to amortization, and it should be noted that no service company reported this reconciling adjustment, which is consistent with their business operations. These decreasing effects are consistent with the different expensing policies under U.S. GAAP and IFRS, and have the

potential to reduce certain book-tax differences due to the elimination of book-tax basis differences that are written off under U.S. GAAP.

The most significant reconciling item as identified theoretically, regards income taxation. All but one company reported a material reconciling adjustment dealing with taxation. The majority of service companies reported increasing effects; however some companies were split between years, meaning in one year they may have reported a decreasing effect. The same concept goes for manufacturing companies, however financial services companies only reported increasing adjustments. These findings are consistent with the notion that reconciling adjustments related to income taxation items are significant and are more likely to increase net income when reconciling IFRS back to U.S. GAAP. It is also important to note that these reconciling items mainly deal with adjustments due to other balance sheet and income statement items rather than methodology differences between U.S. GAAP and IFRS.

Chapter #5
Statement of Opinion

Concluding Overview

Understanding how a convergence of U.S. GAAP and International Financial Reporting Standards will affect the gap between what a company reports as income through required financial statements, and what companies report as income for tax purposes is important not only for companies and management in particular, but also for investors, creditors, and others who rely on financial statements to make decisions. In 2008, over 100 companies worldwide require or permit IFRS reporting, and in 2002 the FASB and IASB proposed a timeline for a convergence to IFRS among U.S. companies with an ultimate decision to be made in the year 2011. Through theoretical and analytical research, the affect that a U.S. convergence with IFRS has on the book-tax gap was examined.

The underlying purpose of IFRS is to make financial statements more useful through increased comparability. Since it can be argued that deferred tax makes financial statements less useful due to the complexity and difficulty in understanding, if IFRS reduces these balances, then it can inferred that understandability will increase. The opposite is also true in that if deferred tax balances increase under IFRS, increased comparability may come at the cost of decreased understandability. Through both a theoretical and analytical approach, it has been shown that it is difficult to be precise on the impact that specific companies will face in a convergence with IFRS. In order to gain some understanding however, the impact of reconciling IFRS to U.S. GAAP was examined.

Basic Statements of Opinion

I have come to several basic opinions regarding four broad areas covered. The first area pertains to the general concept of the book-tax gap. It can easily be misunderstood that this gap

only results due to tax sheltering behavior, and that only companies with significant resources can take advantage of such tax shelters. Current book reporting requirements, or U.S. GAAP, and book reporting behavior, such as earnings management and fraud, however, shapes the book income. The debate over whether the books for tax and financial accounting purposes is one that lacks sufficient understanding, and the concept of one set of books would not only be burdensome, but would not result in an overwhelmingly meaningful outcome due to the two distinct and separate purposes of tax accounting and financial accounting.

Regarding the overall convergence of U.S. GAAP with IFRS, due to the fact that standards are seen to be more principles based under IFRS, it is widely communicated that companies may have the chance to better their financial positions through strategic management. Although overall reported earnings may and will increase across the board due to a convergence with IFRS, it is doubtful that companies and management will take all possible chances to better their financial position and increase earnings beyond a reasonable point, as this may call serious attention from investors, creditors, and others who rely on the financial statements as to the integrity to management.

With respect to the various reconciling adjustments a company reports when reporting under IFRS and reconciling to U.S. GAAP, the adjustments depend on the nature of the company, and no specific trend can be seen over time in companies or among industries. A more extensive analysis would have to be conducted in order to link the nature of a company's reported reconciling adjustments to the company as a whole, the industry in which they operate, the current economic conditions, and other various influences on the business.

Finally, the unforeseen consequences resulting from a convergence with IFRS on the book-tax gap will significantly outweigh the foreseen consequences. It would be difficult to

describe the foreseen consequences in full through trying to describe whether the overall book-tax gap would either widen or narrow due to the vast amount of information that would be needed to be analyzed and other variables such as a specific company's operations and the overall nature of the company, among others. The added administrative burden and cost, as well as the challenges that investors and users of the financial statements will face will only be some of the overriding factors that will result in context to the book-tax gap with a convergence to IFRS.

Appendix

Appendix: Figure 1

	U.S. GAAP	IFRS	U.S. Tax Method	Implications
Revenue Recognition				
Sale of goods	Revenue is recognized when it is realized/realizable and earned: 1) Persuasive evidence of an arrangement exists 2) Delivery has occurred or services have been rendered 3) The price is fixed or determinable and 4) Collectability is reasonably assured.	Revenue is recognized when 1) Significant risks and rewards of ownership have been transferred 2) The seller retains neither continuing managerial involvement nor effective control 3) Revenue can be measured reliably 4) It is probable that the economic benefits will flow to the company and 5) Costs can be reliably measured.	Revenue generally is recognized when there is a fixed right to receive the income and the amount is determinable with reasonable accuracy. With respect to a sale of goods, revenue generally is recognized when the goods are shipped, delivered, or accepted.	Book-tax differences likely will occur only if the income is due or paid in advance of being earned.
Sale of goods (subject to installation)	If goods are shipped subject to installation, revenue must be deferred if the installation is essential to the functionality of the equipment.	If goods are shipped subject to installation and the installation is a significant part of the contract, revenue is not recognized until the installation is complete.	Revenue is deferred until the installation is complete generally only if the taxpayer does not have a right to receive income from the provision of goods until the installation is complete.	No significant change.
Service arrangements	U.S. GAAP prohibits the use of the percentage-of-completion model to recognize revenue under service arrangements unless specific criteria are met.	When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue is recognized by reference to the stage of completion using the percentage-of-completion method.	The percentage-of-completion method is prohibited for the recognition of revenue for services.	Revenue may be accelerated under IFRS, resulting in larger deferred tax liabilities.
Service arrangements (with right of refund)	A right of refund may prevent recognition of service revenue until the right of refund expires.	A right of refund does not prevent the recognition of service revenue if the outcome of the contract can be reliably measured and it is probable the company will receive the economic benefits related to the services provided.	Service revenue is earned when the required services are complete. A right of refund generally would be considered a condition subsequent that would not delay the recognition of revenue.	Potential to reduce the book-tax gap. Revenue may be accelerated under IFRS, resulting in larger deferred tax liabilities.

Multiple element arrangements

When an arrangement involving two or more deliverables does not meet the separation criteria, it must be accounted for as one unit of accounting.

The revenue recognition criteria are usually applied separately to each transaction.

Revenue generally is earned as each good is provided and/or the required services are completed.

Potential to reduce the book-tax gap.

Construction contracts (contingent recognition)

Contingent revenue is included in total contract price when it is probable and measurable. As defined under U.S. GAAP, probable is measured as 75–80%.¹

Contingent revenue is included in total contract price when it is probable and measurable. As defined under IFRS, probable is measured as greater than 50%.²

Contract revenue includes all revenue that the taxpayer reasonably expects to receive under the contract. This must include contingent revenue, no later than when it is included for financial reporting purposes under U.S. GAAP.

Revenue may be accelerated under IFRS, resulting in larger deferred tax liabilities.

¹ PricewaterhouseCoopers, “IFRS, US GAAP, and US tax accounting methods,” February 2009, [http://www.pwc.com/extweb/pwcpublications.nsf/docid/091AE5F7F1C926E6852575590076EDA7/\\$file/ifrs_tax_accounting_methods_0209.pdf](http://www.pwc.com/extweb/pwcpublications.nsf/docid/091AE5F7F1C926E6852575590076EDA7/$file/ifrs_tax_accounting_methods_0209.pdf).

² IBID.

Appendix: Figure 2

	U.S. GAAP	IFRS	U.S. Tax Method	Implications
Property, Plant, & Equipment				
Valuation	Requires historical cost accounting.	Permits historical cost or fair value accounting. Thus, allows revaluation of property, plant, and equipment at fair value.	Cost generally must be used as the basis of property, plant, and equipment.	No significant change.
Components of assets (aggregation and separation)	Permits the separate significant component method, but does not require it.	Requires separate significant components of an item of property, plant, and equipment to be recorded and depreciated separately.	Must follow the unit of property principles, which is determined considering the functional interdependence of one component with another. Separate significant components typically are not treated as separate units of property.	As a result, taxpayers theoretically will need to analyze separate significant components to determine the appropriate tax treatment under unit of property rules, and where required, combine separate components into a single unit of property.
Components of assets (removal costs)	U.S. GAAP allows for capitalization of subsequent expenditures if the expenditure benefits future periods by extending the useful or productive life of the asset. However, there is no requirement that the carrying amount of the parts that are replaced be expensed.	Subsequent expenditures are covered by the same recognition principles as the original property, plant, and equipment purchase. The carrying amount of the parts that are replaced should be written off to expense at the time of replacement.	If the retirement and removal of a depreciable asset occurs in connection with the installation or production of a replacement asset, the costs incurred in removing the retired asset are not required to be capitalized as part of the cost of the replacement asset.	Potential to reduce the book-tax gap.
Asset retirement obligations (AROs)	Asset retirement obligations are added to the carrying amount of the related item of property, plant, and equipment, and depreciated over the useful life of the asset.	The cost of an item of property, plant, and equipment includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.	Asset retirement obligations included in the basis of fixed assets for financial statement purposes need to be removed for tax purposes.	Book-tax difference continues and possibly increases under IFRS.
Interest capitalization (effect of incidental income)	Investment income is recognized in the profit and loss statement as income.	Investment income reduces borrowing costs eligible for capitalization.	Investment income earned on borrowed funds may not reduce interest expense subject to capitalization. Rather, investment income must be recognized as income.	Book-tax difference is created under IFRS.

Appendix: Figure 3

	U.S. GAAP	IFRS	U.S. Tax Method	Implications
Research & Development				
Internally generated research and development costs	Both research and development costs generally are charged to expense as incurred.	The determination as to whether an internally generated intangible asset should be recognized depends on the phase of development in which the cost is incurred. Expenditures for research shall be recognized as an expense when incurred. Capitalization in the development phase is required if specific criteria are met, it is not a choice.	Research or experimental costs may be expensed or capitalized and amortized over five years.	Potential to reduce the book-tax gap.
Acquired in-process research and development (IPR&D)	Acquired IPR&D is expensed immediately unless it has an alternative future use.	Acquired IPR&D is recognized as a separate intangible asset if it meets the definition of an intangible asset and its fair value can be reliably measured, subject to amortization upon completion or impairment.	Acquired IPR&D must be capitalized, and is amortized over its determinable useful life or the 15-year safe harbor.	Potential to reduce the book-tax gap.

Appendix: Figure 4

	U.S. GAAP	IFRS
Income Taxes	Comprehensive interperiod allocation using liability method (balance sheet orientation) is required.	Comprehensive interperiod allocation using liability method (balance sheet orientation) is required under IFRS, very similar to U.S. GAAP.
	Benefit of uncertain tax positions can only be recognized to the extent that there is at least a 50% likelihood of being sustained upon exam.	No specific guidance on uncertain tax positions (apply general approach for contingent losses).
	Recognize effect of rate changes when enacted.	Recognize effects of rate changes when "substantively enacted" which may precede U.S. GAAP reconciliation.
	Deferred tax assets and liabilities are current or noncurrent based on related asset or liability.	Deferred tax assets and liabilities are noncurrent.
	Recognize deferred tax asset in all cases, provide reserve when realization is not "more likely than not."	Recognize deferred tax asset when realization is probable, which basically means "more likely than not."

Appendix: Figure 5

Company Name	Profit attributable to equity holders under IFRS			Net income under GAAP		
	FY 2006	FY 2005	FY 2004	FY 2006	FY 2005	FY 2004
Vodafone Group*	(5,168,000,000)	(21,726,000,000)	6,626,000,000	(4,325,000,000)	(13,270,000,000)	(13,752,000,000)
Reuters Group	305,000,000	459,000,000	357,000,000	306,000,000	396,000,000	439,000,000
InterContinental Hotels Group	405,000,000	492,000,000	380,000,000	486,000,000	355,000,000	340,000,000
Cadbury Schweppes	1,169,000,000	765,000,000	525,000,000	1,034,000,000	585,000,000	484,000,000
GlaxoSmithKline	5,389,000,000	4,689,000,000	3,908,000,000	4,465,000,000	3,336,000,000	2,732,000,000
Diageo	1,489,000,000	1,908,000,000	1,344,000,000	1,592,000,000	1,427,000,000	1,470,000,000
Prudential Public Limited Company	874,000,000	748,000,000	517,000,000	705,000,000	1,192,000,000	91,000,000
The Royal Bank of Scotland Group	6,202,000,000	5,392,000,000	4,856,000,000	5,440,000,000	4,475,000,000	3,909,000,000
Barclays Bank	4,571,000,000	3,447,000,000	3,254,000,000	4,318,000,000	2,932,000,000	3,032,000,000
National Westminster Bank	2,586,000,000	2,446,000,000	2,316,000,000	2,423,000,000	2,142,000,000	2,072,000,000
Averages	£1,782,200,000	-£138,000,000	£2,408,300,000	£1,644,400,000	£357,000,000	£81,700,000

Company Name	Percent change (IFRS to U.S. GAAP)		
	FY 2006	FY 2005	FY 2004
Vodafone Group*	16.31%	38.92%	-307.55%
Reuters Group	0.33%	-13.73%	22.97%
InterContinental Hotels Group	20.00%	-27.85%	-10.53%
Cadbury Schweppes	-11.55%	-23.53%	-7.81%
GlaxoSmithKline	-17.15%	-28.85%	-30.09%
Diageo	6.92%	-25.21%	9.38%
Prudential Public Limited Company	-19.34%	59.36%	-82.40%
The Royal Bank of Scotland Group	-12.29%	-17.01%	-19.50%
Barclays Bank	-5.53%	-14.94%	-6.82%
National Westminster Bank	-6.30%	-12.43%	-10.54%
Averages	-2.86%	-6.53%	-44.29%

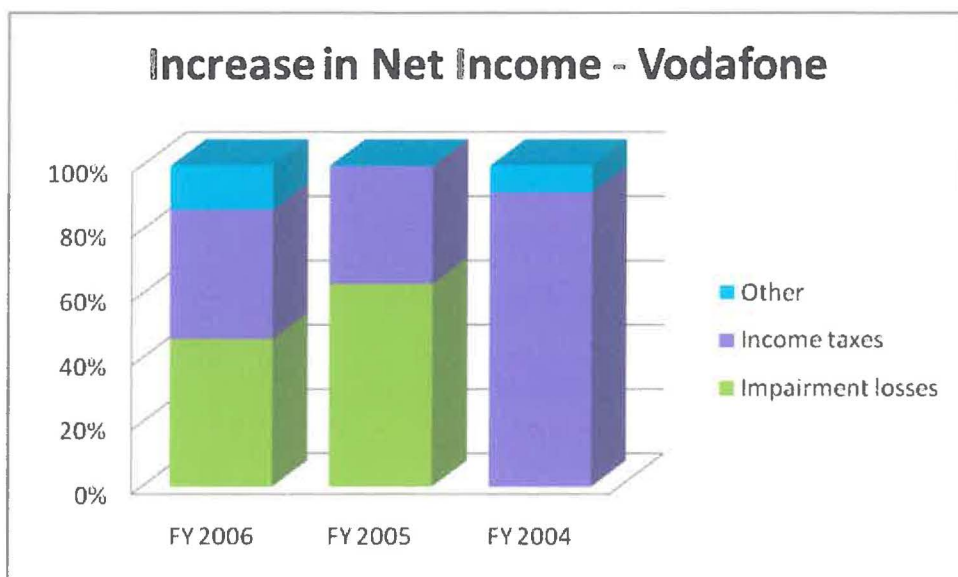
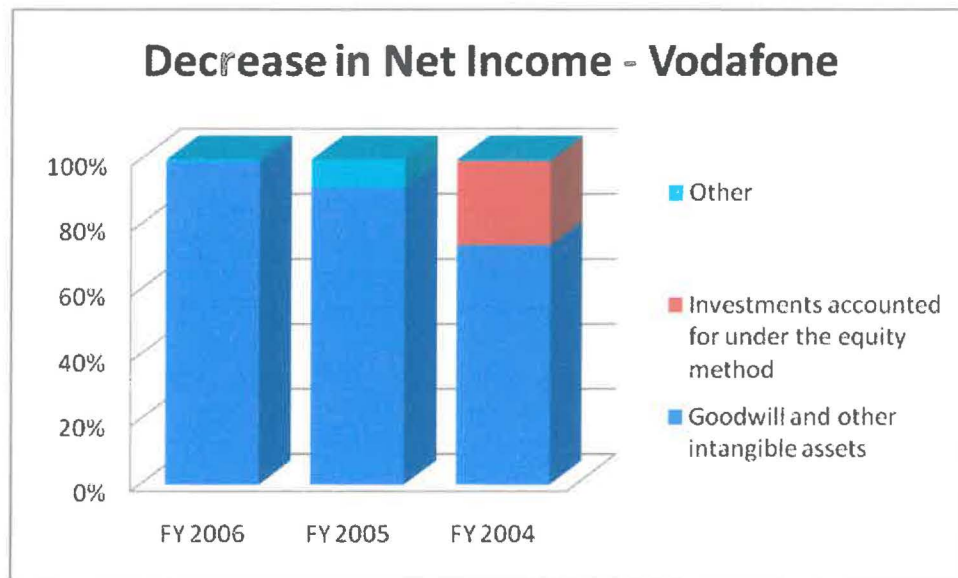
Company Name	Difference attributable to taxation			Absolute value of taxation difference		
	FY 2006	FY 2005	FY 2004	FY 2006	FY 2005	FY 2004
Vodafone Group*	5,862,000,000	8,902,000,000	6,680,000,000	20.92%	22.25%	23.55%
Reuters Group	(29,000,000)	18,000,000	(62,000,000)	20.00%	10.17%	17.71%
InterContinental Hotels Group	82,000,000	14,000,000	(75,000,000)	30.80%	7.73%	33.88%
Cadbury Schweppes	15,000,000	(76,000,000)	(26,000,000)	7.61%	33.78%	16.77%
GlaxoSmithKline	292,000,000	538,000,000	747,000,000	11.68%	24.91%	27.24%
Diageo	158,000,000	(234,000,000)	313,000,000	35.19%	45.44%	46.86%
Prudential Public Limited Company	194,000,000	92,000,000	65,000,000	1.86%	0.01%	1.57%
The Royal Bank of Scotland Group	410,000,000	223,000,000	240,000,000	16.94%	13.59%	14.08%
Barclays Bank	12,000,000	215,000,000	(2,000,000)	0.77%	10.85%	0.12%
National Westminster Bank	7,000,000	68,000,000	118,000,000	2.53%	10.86%	17.82%
Averages	£700,300,000	£976,000,000	£799,800,000	14.83%	17.96%	19.96%

*Vodafone Group has a fiscal year end of March 31

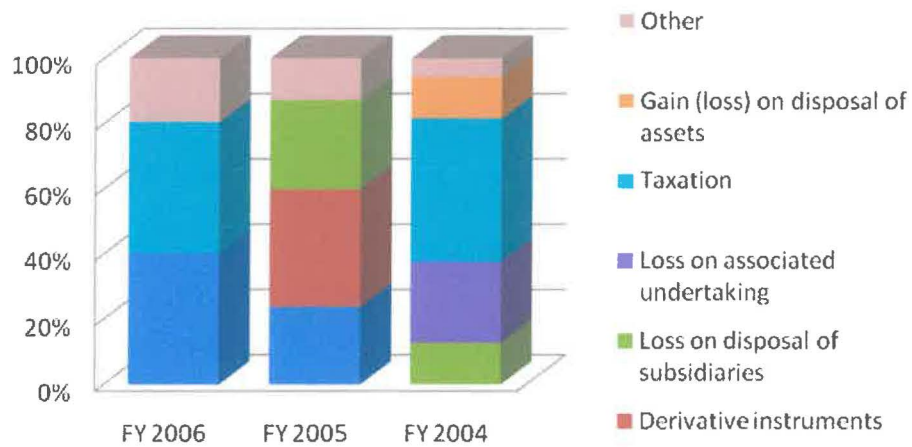
All figures in pounds (£)

Service Companies
Manufacturing Companies
Financial Services Companies

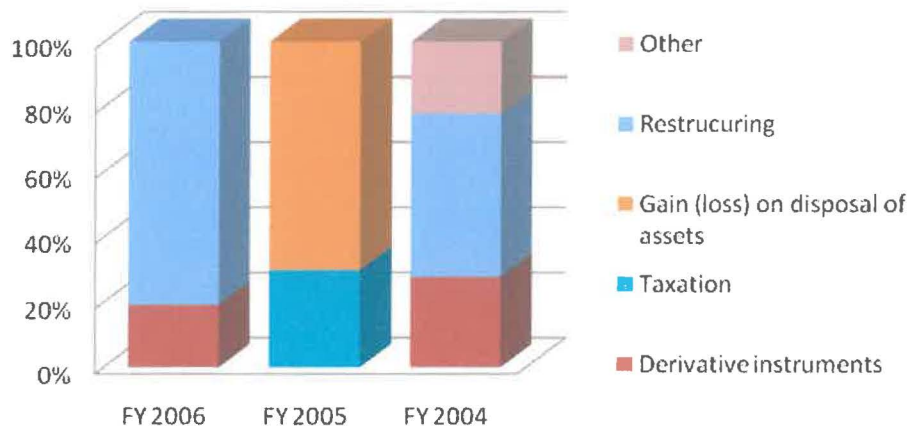
Appendix: Figure 6



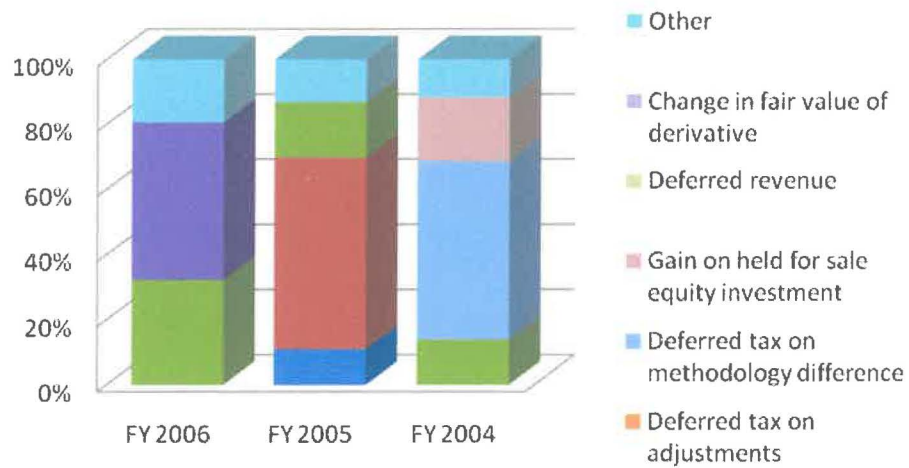
Decrease in Net Income - Reuters



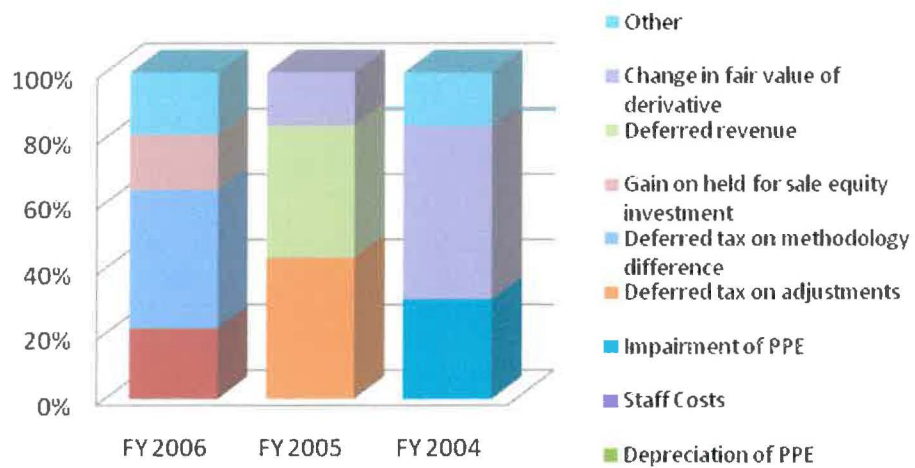
Increase in Net Income - Reuters



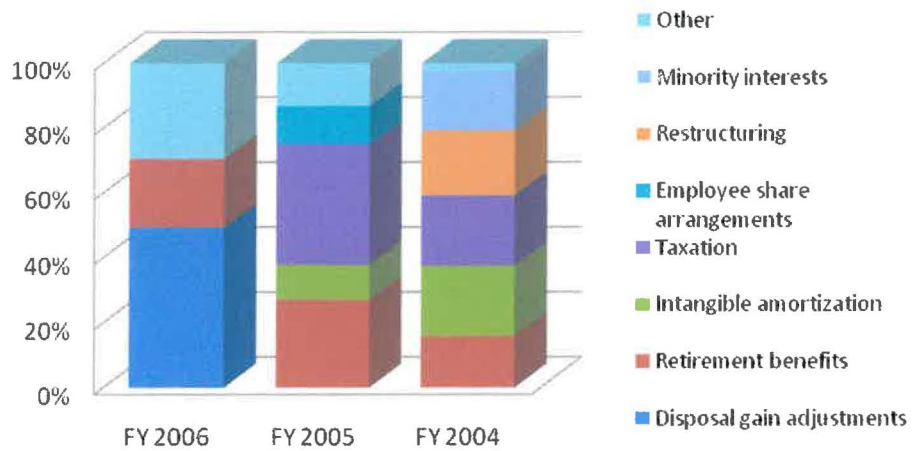
Decrease in Net Income - IHG



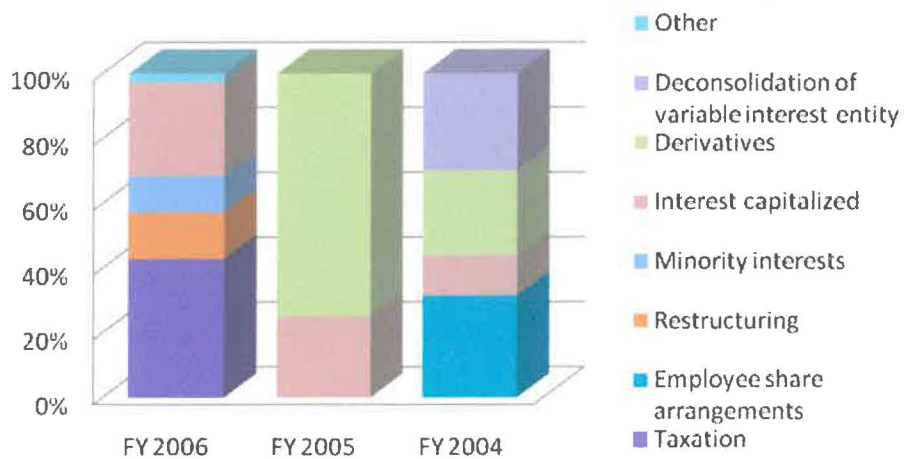
Increase in Net Income - IHG



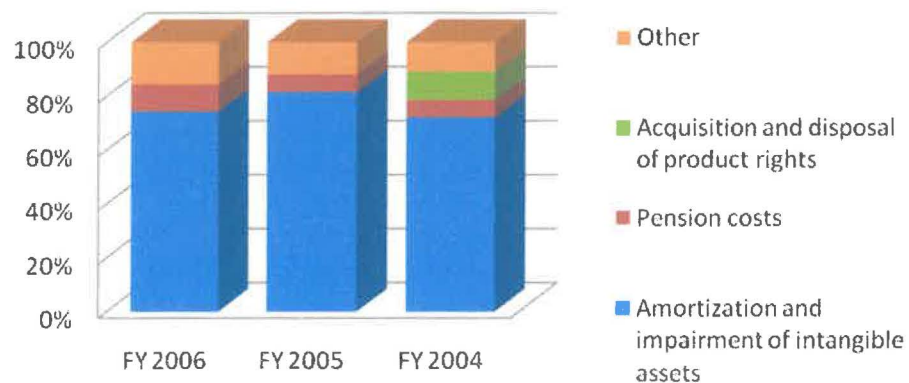
Decrease in Net Income - Cadbury



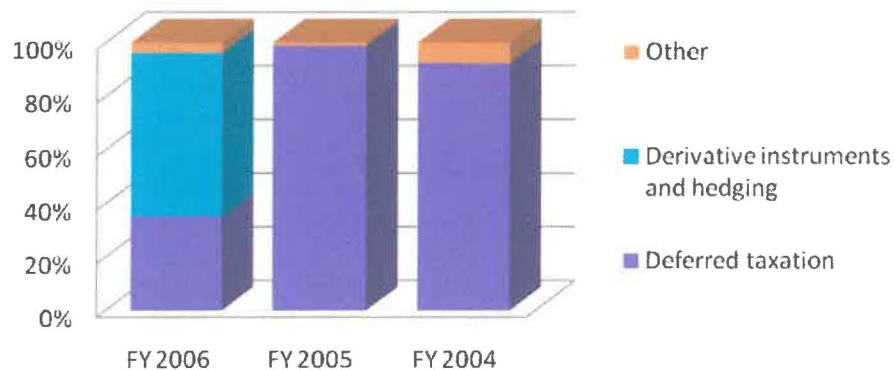
Increase in Net Income - Cadbury



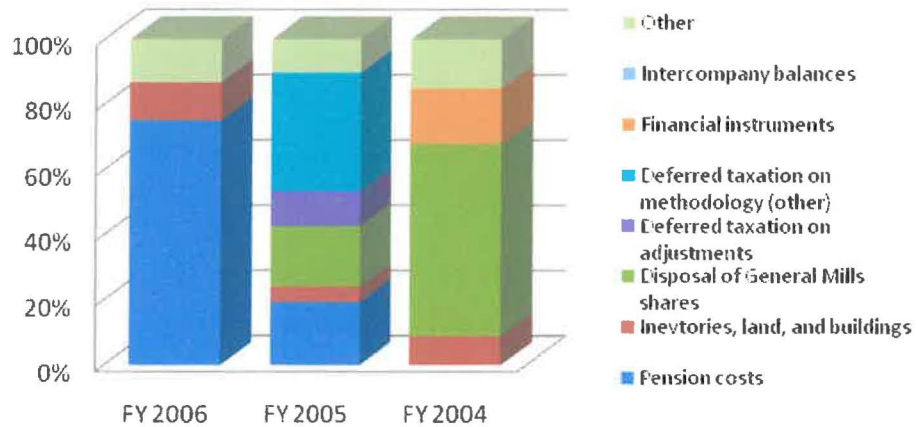
Decrease in Net Income - GlaxoSmithKline



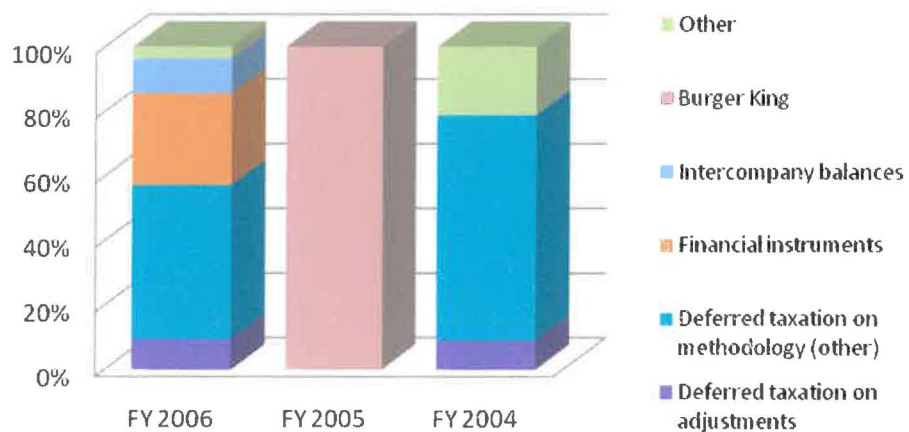
Increase in Net Income - GlaxoSmithKline



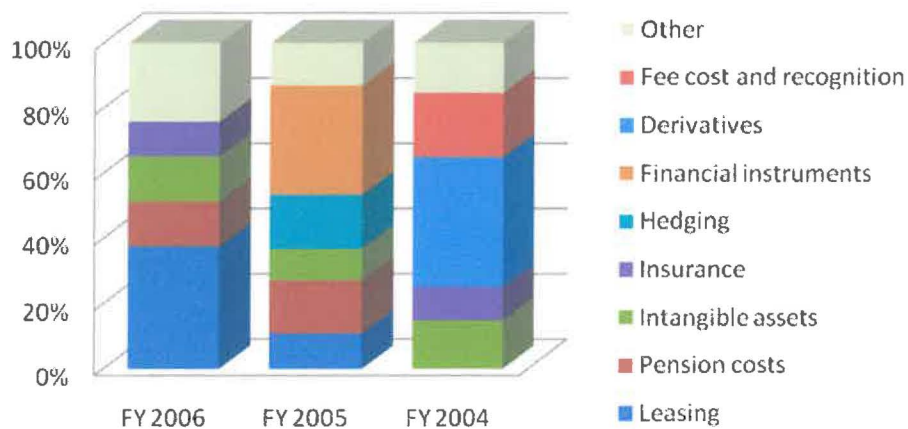
Decrease in Net Income - Diageo



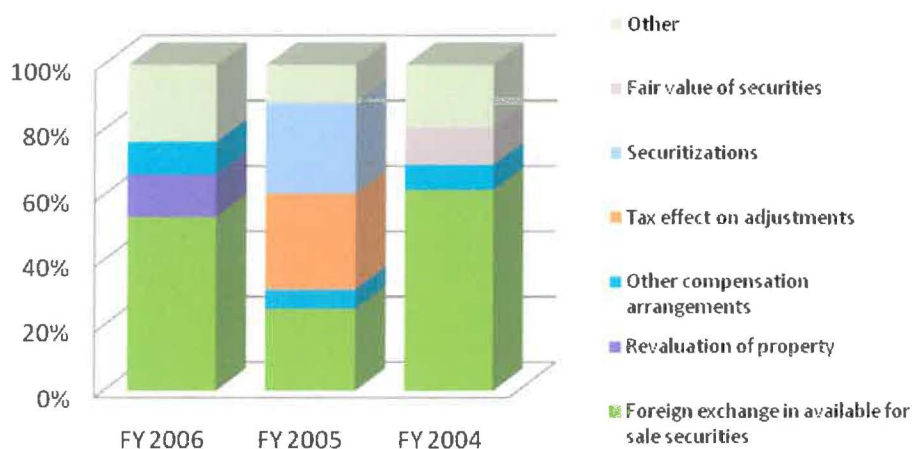
Increase in Net Income - Diageo



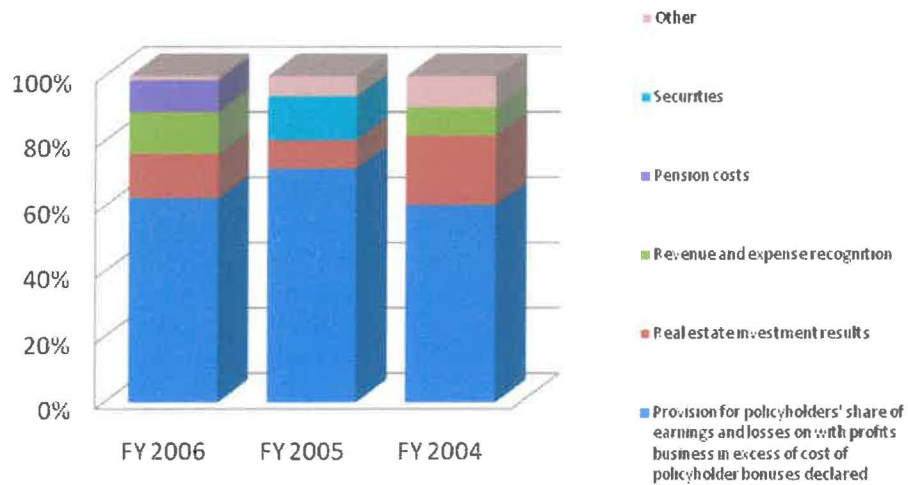
Decrease in Net Income - Barclays



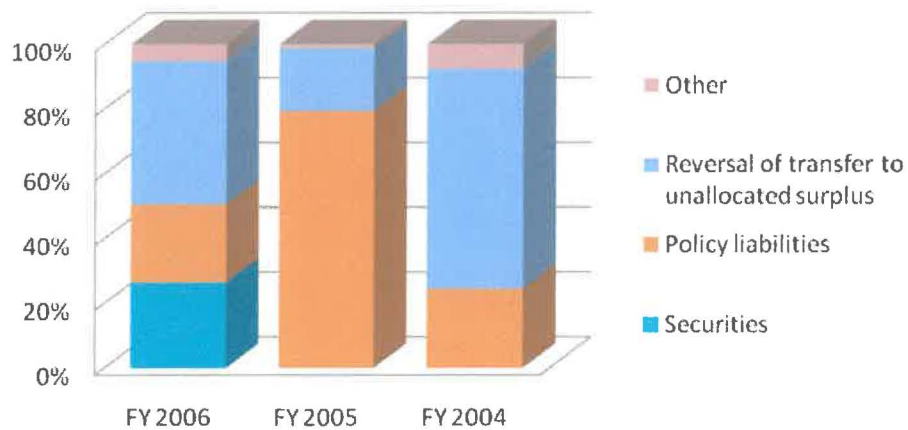
Increase in Net Income - Barclays



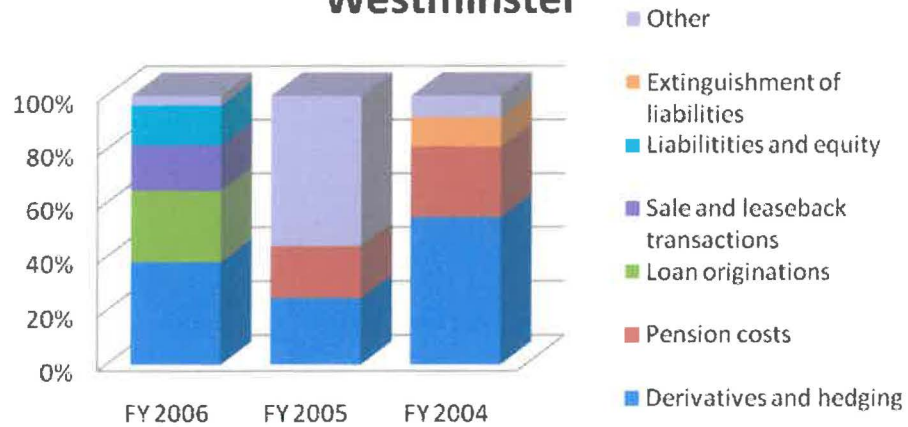
Decrease in Net Income - Prudential



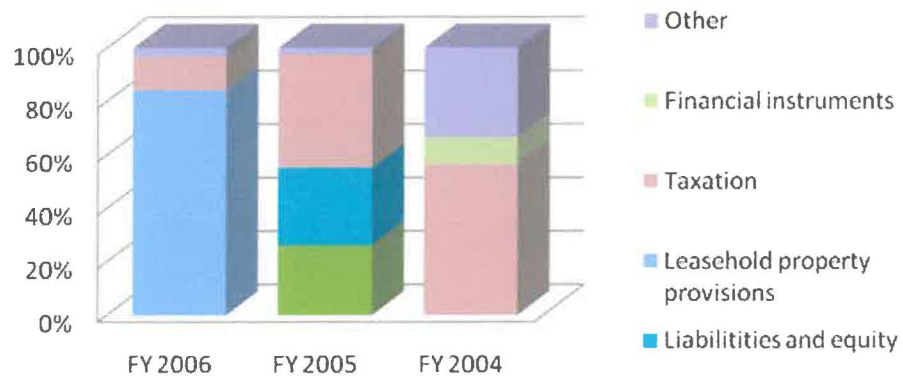
Increase in Net Income - Prudential



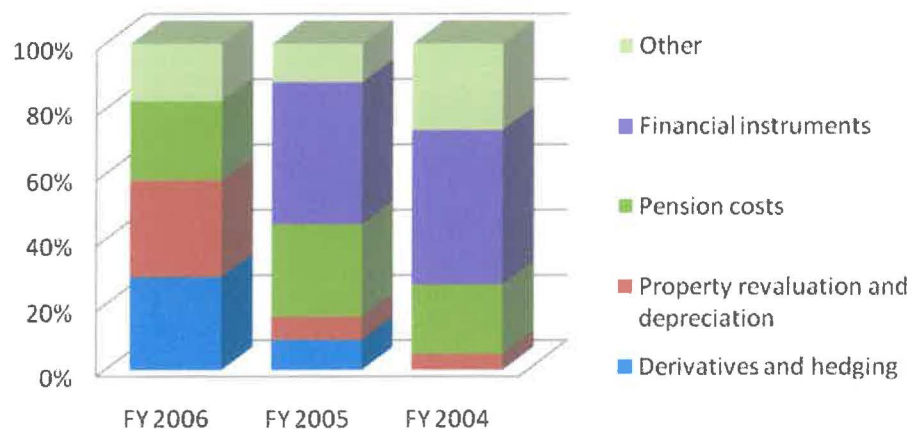
Decrease in Net Income - National Westminster



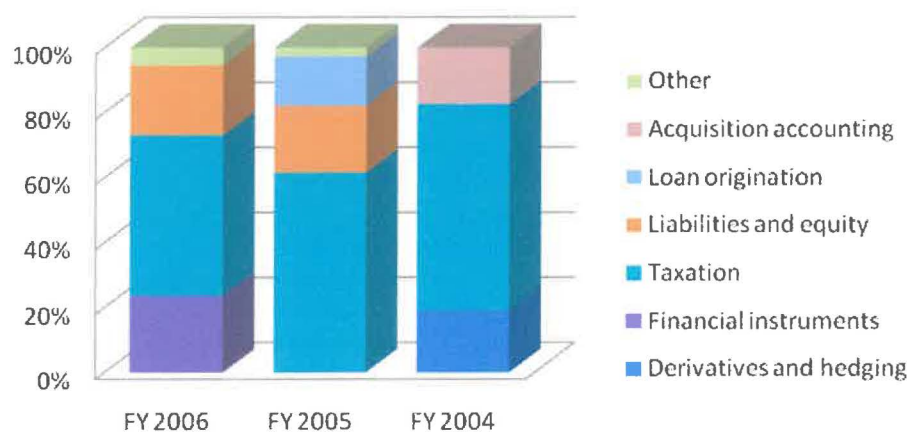
Increase in Net Income - National Westminster



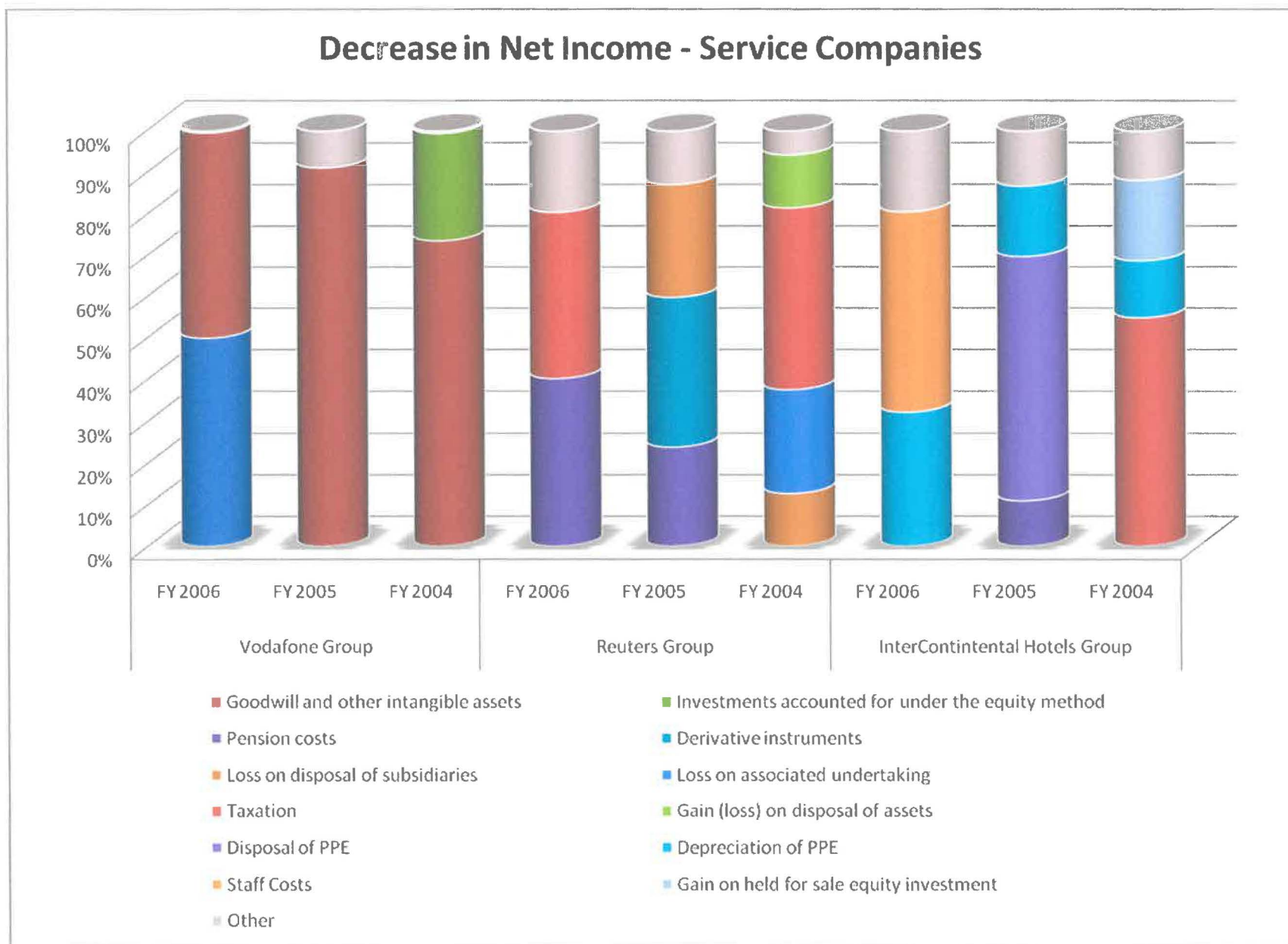
Decrease in Net Income - RBS



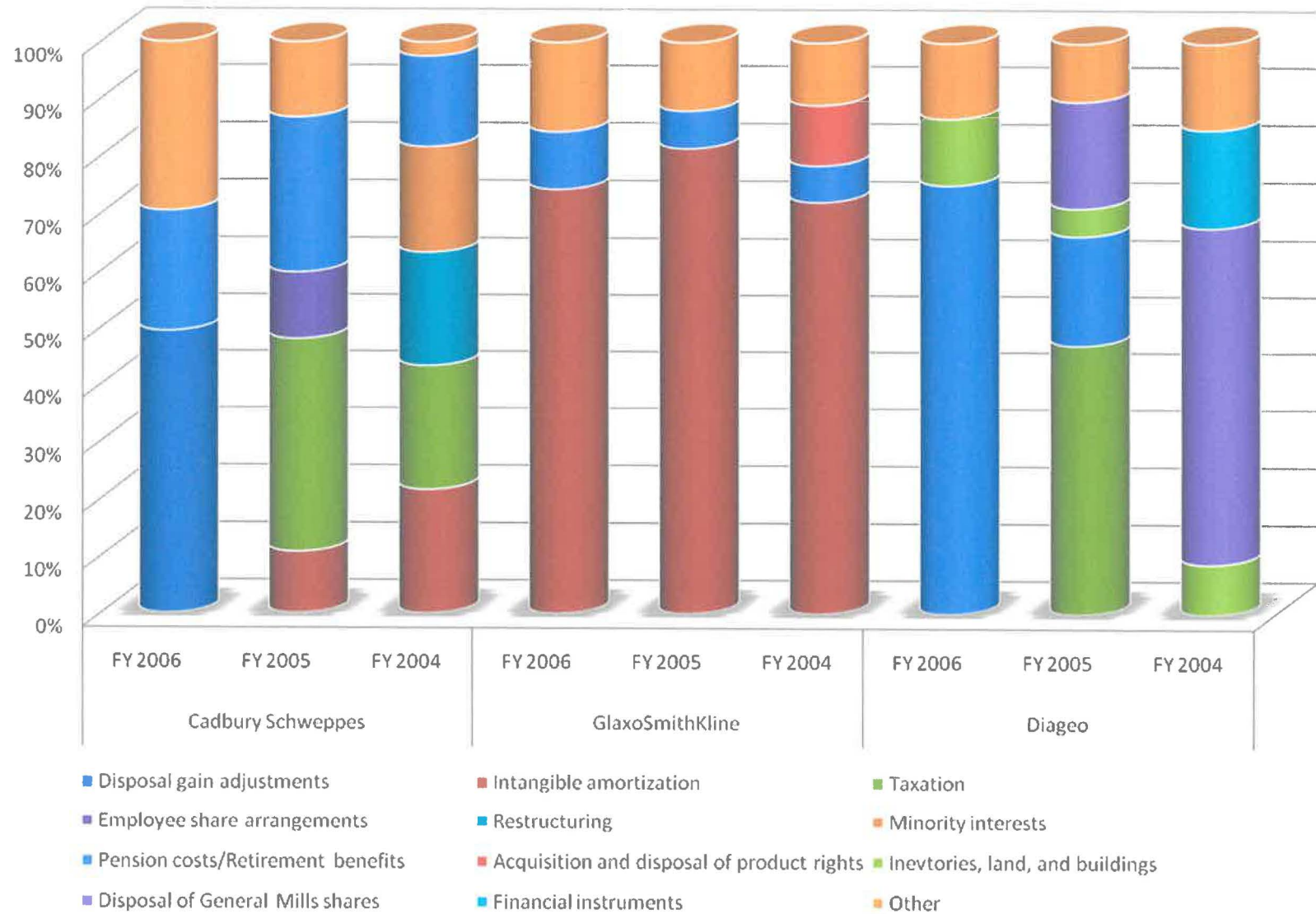
Increase in Net Income - RBS



Appendix: Figure 7



Decrease in Net Income - Manufacturing Companies



Decrease in Net Income - Financial Service Companies

